Chartered Professional Accountants | CPA PROFESSIONAL PROGRAM

Sample CPA Professional Program Exams – Objective-Format Questions

Foundational Development

The sample examination questions provided in this package are intended to offer a general indication of the format, structure, and nature of questions that candidates may encounter. While these materials have been developed with careful consideration and are intended to be broadly representative, they are not exhaustive and cannot capture the full range of possible question variations. These samples should therefore be used as a guide rather than a definitive representation.

Note to reader: Objective-format questions may include, but are not limited to: multiple-choice questions, multiple-select questions, fill in the blank, etc.

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FOUNDATIONAL DEVELOPMENT

Assurance and trust

Sample question 32

TechStar Inc. is a public company with an aim to “drive business solutions through technological innovation.” It hopes to secure financing soon to launch a new project. A new audit firm has been engaged to complete the audit of the 2026 year-end financial statements.

Select the factor that increases the risk of material misstatement at the financial statement level.

a. TechStar Inc. is hoping to secure financing in the near future.

b. TechStar Inc. operates in the fast-moving technology sector.

c. The audit firm is new and may not be sufficiently familiar with TechStar Inc.

d. The new project may be consuming employees’ time.

Solution:

A. Correct. TechStar may feel pressure to show strong financial results on its financial statements in order to secure financing. As a result, it may manipulate the financial statements.

B. Incorrect. The technology sector being fast moving may increase assertion-level risk (e.g., valuation of intangible assets) but on its own does not increase the risk of material misstatement at the financial statement level.

C. Incorrect. Being new to the engagement will necessitate additional work in order to become familiar, and may increase the risk that the auditor will detect errors present (hence the additional work to mitigate this risk), but it doesn’t increase the risk that material misstatements already exist in the financial statements.

D. Incorrect. While a new project may indeed involve a time commitment, that does not mean this new project would increase the risk of material misstatement. Given the level of regulatory requirements a public company needs to follow, the employees in finance and accounting should be relatively sophisticated and unlikely to be affected by additional time commitments from a new project to the extent that risk of material misstatement would be impacted.

Sample question 33

An auditor has historically used a combined audit approach over the sales cycle for an existing client with a December year-end. During the current year, the client's sales volumes increased significantly when their products went viral online. As a result, the sales clerk fell behind in recording transactions. In October, management hired a temporary assistant for the sales clerk to perform data entry and get caught up before year-end. Sales cycle processing and approvals remain otherwise unchanged.

Select the most appropriate audit approach the auditor will plan for the current year, considering these circumstances.

a. Reassess the planned reliance on controls and perform additional testing of controls for periods affected by increased volume and staffing changes.

b. Continue with the prior year's combined approach and maintain the same level of control reliance, since the underlying processes have not changed.

c. Shift to a fully substantive approach for the fiscal year and eliminate testing of controls over the sales cycle due to the staffing change.

d. Focus primarily on substantive testing of revenue and receivables balances at year-end, since the staffing change occurred late in the year.

Solution:

A. Correct. The surge in sales volume and addition of a temporary assistant for data entry introduce heightened risk of errors and control breakdowns, particularly in transaction processing. The auditor should reassess control reliance, perform targeted control testing for the affected periods (including the new clerk's work), and increase substantive procedures where reliance cannot be supported. This reflects a risk-based combined approach.

B. Incorrect. Although the process may appear similar, the operating effectiveness of controls may have changed due to volume pressures and new personnel performing some data entry. Failing to reassess control reliance is inappropriate.

C. Incorrect. Moving to a fully substantive approach may be overly conservative and inefficient, especially for an existing client with historically effective controls. The appropriate response is reassessment, not abandonment.

D. Incorrect. Revenue is a throughout-the-year transaction stream, and risks arising from increased volume and staffing changes would not be addressed by focusing only on year-end balances.

Sample question 34

You are a CPA auditor reviewing internal controls over purchases, accounts payable, and cash disbursements at Granite Point Manufacturing Inc. You note the following:

- The purchasing manager creates purchase orders and also approves them, regardless of the dollar amount.
- Warehouse staff prepare receiving reports, and the accounts payable clerk matches these to purchase orders and supplier invoices before recording payables.
- The accounts payable clerk can add and change vendor master file information, prepares the payment run, prints cheques with a facsimile signature, and mails the cheques to suppliers.
- The accounts payable clerk prepares the monthly bank reconciliation, which no one else reviews.

Select the statement that correctly analyzes the effectiveness of these controls.

a. There are significant control weaknesses because key duties in the purchases and cash disbursements cycle are not properly segregated: The accounts payable clerk can create or change vendors, record payables, initiate and complete payments, and prepare unreconciled bank reconciliations, increasing the risk of unauthorized or fraudulent payments.

b. The controls appear effective overall because the accounts payable clerk performs a 3-way match of purchase orders, receiving reports, and supplier invoices before recording payables, which eliminates the risk of errors or fraud in cash disbursements.

c. The main issue is that the purchasing manager both creates and approves purchase orders, but the strong control provided by the accounts payable clerk handling all subsequent steps reduces the overall risk of misstatements.

d. The controls are acceptable because any weaknesses in segregation of duties are offset by the monthly bank reconciliation prepared by the accounts payable clerk, which ensures that all unauthorized payments would be detected.

Solution:

A. Correct. This statement properly analyzes the controls by identifying a major segregation-of-duties problem. The accounts payable clerk can set up or change vendors, record payables, initiate and complete payments, and prepare bank reconciliations that no one reviews. This concentration of duties allows the same person to create, pay, and conceal unauthorized or fraudulent payments, which is a significant control weakness.

B. Incorrect. A 3-way match is a good control, but it does not “eliminate” the risk of errors or fraud, especially when one person controls vendor setup, payment processing, and reconciliations. This option ignores the segregation-of-duties issues and overstates the effectiveness of the control.

C. Incorrect. This option correctly notes a problem with the purchasing manager creating and approving purchase orders, but it then treats the accounts payable clerk doing “all subsequent steps” as a strength. In reality, concentrating all those duties in one person increases risk and is a key weakness, not a mitigating factor.

D. Incorrect. Relying on a monthly bank reconciliation prepared by the same accounts payable clerk, with no independent review, does not compensate for poor segregation of duties. The person who could process an unauthorized payment is also in a position to hide it, so this reconciliation does not ensure detection of unauthorized payments.

Big data and data analytics

The learning outcomes for this competency are the same for both Knowledge Assessment and Foundational Development. See Knowledge Assessment for samples of questions.

Ethical decision-making and organizational governance/data governance

Sample question 35

Fair Ware Co., a publicly traded company, recently made a statement indicating that environmental stewardship is among its core values. Its board is considering how best to align this value with governance responsibilities.

Select the board action that best demonstrates genuine alignment between this stated value and the company's sustainability strategy.

a. The board integrates material environmental risks into its enterprise risk management oversight, discloses those risks in its Management Discussion & Analysis, and ties its strategic decisions to environmental stewardship.

b. The board delegates responsibility for environmental oversight to the company's sustainability function and approves the annual sustainability report before it is filed.

c. The board instructs management to adopt a voluntary set of sustainability reporting standards, such as the Global Reporting Initiative (GRI), and to report results on a regular basis.

d. The board sets a net-zero emissions target to be achieved within a period of 10 years.

Solution:

A. Correct. Aligning stated core values and governance responsibility means the board must actively oversee environmental risk as part of its enterprise risk management. Having consistency between stated values and strategic decision-making is a strong indicator of genuine governance alignment.

B. Incorrect. Delegating oversight to the sustainability team and limiting the board's role to passively approving the annual report is not sufficient to align core values with governance responsibility. The board retains a responsibility to oversee material risks, including those related to environmental stewardship.

C. Incorrect. While adopting a voluntary reporting framework, like GRI, and reporting on a regular basis is a best practice, on its own it will not be sufficient to satisfy the board's governance responsibilities. Adopting voluntary standards and reporting on them is only meaningful to the extent that the board engages with the reporting, monitors results, and seeks to improve on them.

D. Incorrect. Setting an emissions target does not necessarily fulfill the board's governance responsibilities, including its fiduciary or disclosure duties. The board needs to ensure that the target is material, it has considered the relevant sustainability risks and opportunities, it intends to monitor progress towards this target and engage in strategic decision-making that aligns with this target, and it links the target to the company's stated values.

Sample question 36

Select the response that best describes a sound data governance practice for a service organization that manages customer information across multiple business units.

a. Establish a formal data governance framework that defines clear ownership of customer information, standardized data definitions, documented access controls, and a centralized process for monitoring data quality across all departments that use customer data.

b. Allow each department to design its own informal rules for collecting and storing customer information as long as the department head verbally approves the approach and the data is stored in any convenient format.

c. Focus data governance only on the finance department, because financial reporting is the primary external output, and permit other departments to manage customer information independently without centralized oversight.

d. Store all customer information in a single shared database and allow only those in the IT department to update records, resolve conflicts, or make changes requested by different business units.

Solution:

A. Correct. This option reflects best practices by assigning responsibility, standardizing how customer data is defined and used, controlling access, and monitoring quality across the organization, which supports consistent and compliant use of customer information in all functions.

B. Incorrect. This option lacks formal governance, standardization, and documented controls, which increases the risk of inconsistent and unreliable customer data across the organization.

C. Incorrect. Limiting governance to finance ignores the fact that customer data is used across many functions, which undermines consistency, quality, and compliance in non-financial uses of customer information.

D. Incorrect. Centralizing updates in IT without business ownership or clear governance processes can create bottlenecks and does not address data definitions, quality standards, or shared accountability.

Sample question 37

A not-for-profit organization founded two years ago is experiencing rapid growth in programs and funding. Its board consists of 9 founding members, all of whom began at inception and are nearing the end of their initial 3-year terms. The board has no formal committees and continues to be heavily involved in operational decisions.

Select the most appropriate assessment of the board's effectiveness.

a. The board's structure and activities may limit effectiveness, because lack of renewal, absence of committees, and involvement in operations reduce its ability to provide independent oversight and strategic governance.

b. The board remains effective because founding members have the strongest understanding of the organization and are best positioned to continue guiding both strategy and operations.

c. The board's structure and activities are generally appropriate for a young, growing organization; however, the absence of committees may limit its ability to support continued program growth.

d. The board's effectiveness is generally appropriate at this stage, because its direct involvement in operations helps ensure programs are delivered effectively during a period of growth.

Solution:

A. Correct. An effective board should include renewal and independence, focus on oversight rather than operations, and use committees (e.g., governance, finance) to support its mandate.

B. Incorrect. This is incomplete, so it is less appropriate. While experience is valuable, lack of renewal and independence can reduce objectivity and governance effectiveness, especially as the organization grows.

C. Incorrect. This is not entirely complete. Committee structure is important, but issues also include board composition, independence, and role clarity.

D. Incorrect. This is inappropriate because it overemphasizes operational involvement. As an organization grows, its board should shift towards oversight and strategy rather than direct involvement in day-to-day operations.

Finance

Sample question 38

Clearwater Tech Inc. (CTI) is a profitable, growing company with a strong credit rating. It is seeking $50 million in long-term financing for capital expansion. The CFO's priorities are to minimize the cost of capital and preserve financial flexibility. CTI's current debt-to-equity ratio is 0.3, which is below the industry average of 0.8.

Select the source of financing that best meets the needs of CTI in this case.

a. Issuing long-term unsecured bonds

b. Issuing new common shares through a secondary public offering

c. Seeking venture capital financing

d. Obtaining a revolving line of credit

Solution:

A. Correct. This option allows a financially strong firm to raise large, fixed-rate, long-term funds at relatively low cost without diluting ownership, and it preserves flexibility by not pledging specific assets.

B. Incorrect. This raises permanent capital but increases the cost of equity, dilutes existing shareholders, and may not minimize the overall cost of capital.

C. Incorrect. Venture capital is typically used by early-stage or high-risk firms, often involves significant ownership dilution and control rights, and is not appropriate for an established, profitable issuer.

D. Incorrect. This option relates to working capital and is not a suitable instrument for funding long-term capital expansion.

Sample question 39

ABC Company is evaluating a new automated packaging system expected to reduce labour costs. Two years ago, it spent $220,000 on engineering studies and prototype testing specific to this system. If implemented, the project requires $900,000 in equipment and $120,000 in additional working capital, and it would eliminate an existing product generating $85,000 in annual contribution margin. The company would finance the project with a $1,000,000 bank loan carrying 7% in annual interest expense.

Select the amount that would be excluded from the incremental cash flow analysis for capital budgeting purposes.

a. The $220,000 engineering studies and prototype testing expenditure

b. The $120,000 in additional working capital

c. The $85,000 in lost contribution margin

d. The 7% interest expense

Solution:

A. Correct. Past development outlays are sunk costs and, therefore, excluded.

B. Incorrect. The increase in working capital is an increment cash flow impact for the project and, therefore, included.

C. Incorrect. The foregone contribution from a product that is only dropped if the project proceeds is an opportunity cost and, therefore, included.

D. Incorrect. Financing charges are reflected through the discount rate, which is part of the incremental cash flow analysis.

Sample question 40

PrairieTech Equipment Ltd. is a privately held manufacturer of agricultural equipment. The company is expanding into AI-enabled precision farming equipment, such as autonomous tractors, in response to increasing market demand. Management has prepared forecasts showing uneven and growing cash flows over the next five years, with higher upfront investment and improving margins. The company will continue as a going concern, and comparable transactions are limited in this emerging market.

Select the most appropriate method to value the business.

a. Discounted cash flow method, because it captures varying and growing cash flows and reflects uncertainty in an emerging market.

b. Capitalized cash flow method, because it applies a single rate to expected earnings and reflects ongoing operations.

c. Liquidation value method, because it provides a conservative estimate of the company's value based on asset disposal.

d. Market-based multiples method, because comparable transactions provide observable benchmarks for similar companies.

Solution:

A. Correct. Discounted cash flow method is appropriate when cash flows are uneven and expected to grow. It incorporates timing, risk, and changing performance.

B. Incorrect. Capitalization assumes stable cash flows, which is not appropriate given the variability and growth in this scenario.

C. Incorrect. Liquidation is not appropriate for a profitable going concern with no intention to cease operations.

D. Incorrect. This is reasonable but limited due to few comparable transactions and differing growth profiles in this emerging space.

Financial reporting

Sample question 41

Ridgecrest Logistics Inc. (RLI) prepares its financial statements using IFRS. RLI owns a delivery truck that originally cost $200,000, of which $40,000 was allocated to the engine component. As at January 1, accumulated depreciation of $28,000 had been recorded on the engine. On January 1, RLI replaced the engine at a cash cost of $47,000. The new engine is expected to extend the truck's useful life by 5 years.

Select the appropriate accounting treatment for the replacement of the engine.

a. Capitalize $47,000 as a new component, derecognize the old engine's carrying amount, and recognize a loss of $12,000.

b. Expense the $47,000 replacement cost as repairs and maintenance.

c. Add $47,000 to the carrying amount of the truck and make no further adjustments.

d. Capitalize the excess of cost of the new engine over the original engine and expense the remaining $40,000.

Solution:

A. Correct. IAS 16 Property, plant and equipment provides guidance on this issue. Per IAS 16.70,

   “[A]n entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately.

   Further, per IAS 16.71,

   “The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.”

   The old engine's carrying amount of $40,000 less $28,000 in accumulated depreciation results in a carrying amount of $12,000. Derecognizing the $12,000 carrying amount with no proceeds results in a $12,000 loss on disposal. The new engine ($47,000) is capitalized and depreciated over its new useful life.

B. Incorrect. The fact that the engine was previously capitalized and that the new engine will extend the truck’s useful life by 5 years suggest that this is a capital expenditure. This answer incorrectly recommends expensing a capital expenditure.

C. Incorrect. This answer correctly capitalizes the cost of the new engine but fails to derecognize the replaced component.

D. Incorrect. IAS 16 does not support this treatment of the replaced component. This treatment results in an expense of $40,000, as opposed to the appropriate loss of $12,000 to be recorded on the old engine.

Sample question 42

On January 1, 2026, Rapid Power constructed a wind turbine with a cost of $5,000,000. The company is legally required to dismantle the turbine in 20 years. The estimated dismantling cost is $1,200,000. Rapid uses a 5% discount rate to evaluate such projects. In addition, the government requires an annual environmental monitoring fee equal to 1% of the turbine's cost, payable at the end of each year. Rapid Power reports under IFRS.

Select the amount of decommissioning liability that Rapid would recognize on January 1, 2026.

a. $452,267

b. $601,814

c. $2,365,715

d. $2,486,261

Solution:

A. Correct. IAS 37 Provisions, Contingent Liabilities and Contingent Assets notes,

"36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

"37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time[...]"

Therefore, the decommissioning liability equals the present value of the $1,200,000.00 dismantling outflow discounted at 5.00% over 20.00 years; the annual monitoring fees are period costs and are not included in the liability.

B. Incorrect. This amount overstates the liability by using a shorter discount period than 20 years, increasing the present value above the correct obligation.

C. Incorrect. This value approximates the present value of the dismantling cost plus an incorrect inclusion of some monitoring fees, which should not be capitalized as part of the decommissioning liability.

D. Incorrect. This amount reflects an overstatement from discounting the dismantling obligation at a rate lower than 5%, which inflates the present value of the future cash outflow.

Sample question 43

MapleTech is a Canadian company that uses Canadian dollars as its reporting currency. On December 1, 2026, MapleTech purchased equipment from a US supplier for USD $200,000, on credit. On that same date, MapleTech recognized sales to a US customer for USD $150,000, on credit. MapleTech also owns a piece of land in Germany that it purchased several years ago for 500,000 Euros. MapleTech reports under ASPE.

Relevant exchange rates:

Date	CAD/USD	CAD/Euro
December 1, 2026	1.30	--
December 31, 2026	1.25	1.58
Historical rate for land purchase	--	1.48

Select the amount in Canadian dollars that MapleTech would report on its December 31, 2026, year-end statement of financial position for the foreign currency assets.

a. $1,187,500

b. $1,227,500

c. $1,195,000

d. $1,000,000

Solution:

A. Correct. ASPE Section 1651 states that,

“.16 At each balance sheet date, monetary items denominated in a foreign currency shall be adjusted to reflect the exchange rate in effect at the balance sheet date.

“.18 At each balance sheet date, for non-monetary assets of the reporting enterprise that are carried at market, the Canadian dollar equivalent shall be determined by applying the exchange rate in effect at the balance sheet date to the foreign currency market price.”

Monetary assets (receivable USD 150,000.00) are translated at December 31, 2026 (150,000.00 × 1.25 = 187,500.00), non-monetary assets are measured at historical cost (land EUR 500,000.00; use the historical rate: 500,000.00 × 1.48 = 740,000.00), and equipment (USD 200,000.00) is a non-monetary asset measured at historical cost using the transaction-date rate

(200,000.00 × 1.30 = 260,000.00); total = 187,500.00 + 740,000.00 + 260,000.00 = $1,187,500.00.

B. Incorrect. This calculation uses the year-end FX rates for all assets, which is incorrect for non-monetary assets (equipment and land).

C. Incorrect. This calculation uses the spot rate on the date of the transaction for all assets, which is incorrect for monetary assets (A/R).

D. Incorrect. This calculation omits the inclusion of A/R, which is also an asset.

Sample question 44

Health Matters is a wellness studio specializing in red-light therapy treatments. For the year ending December 31, 2026, Health Matters has reassessed the expected useful life of its red-light therapy equipment, which was originally assessed as 10 years. However, due to improved maintenance and servicing, management now estimates the useful life to be 15 years beginning January 1, 2026.

Select the appropriate accounting treatment as of December 31, 2026, under ASPE.

a. Adjust amortization prospectively beginning January 1, 2026, based on the useful life of 15 years.
b. Continue amortizing the asset using 10-year useful life and disclose the intention to adopt the revised estimate in the subsequent year.
c. Restate the December 31, 2025, financial statements to reflect the revised useful life.
d. Continue amortizing the asset using 10-year useful life and disclose the impact of the revised useful life (15 years) in the notes to the financial statements.

Solution:

A. Correct. Under ASPE Section 1506, a change in useful life is a change in accounting estimate (paragraph 19). It also notes under paragraph 23, “The effect of a change in an accounting estimate, other than a change to which paragraph 1506.24 applies, shall be recognized prospectively by including it in net income in:

   (a) the period of the change, if the change affects that period only; or

   (b) the period of the change and future periods, if the change affects both.”

   Therefore, the change in useful life is applied prospectively, so future amortization is recalculated based on the new duration from the next period.

B. Incorrect. A change in estimate is recognized prospectively in the change of change and future periods, if the change affects both.

C. Incorrect. A change in estimate is not applied retrospectively; prior periods are not restated under ASPE.

D. Incorrect. Disclosure alone is not sufficient; the revised estimate must be reflected in future amortization.

Sample question 45

Luscious Landscaping Inc. is a large company providing all the landscaping services Canadians could need. One of its divisions, operating as “Snowscapes,” provides residential snow-clearing services in cities that experience sufficient snowfalls each year. It follows IFRS.

In an aggressive marketing scheme, after the first big snowfall each year, Snowscapes clears driveways of homes that haven’t been shovelled by the residents yet. It then approaches the residents for payment for that individual service ($50), leaving an invoice in the mailbox if nobody is home. Snowscapes will also attempt to sell them on the full winter subscription.

Historically, residents will often pay for at least the initial snow-clearing out of a feeling of guilt or appreciation, since the work was already done; some will subscribe for the season.

Select the statement that reflects how revenue should be recorded.

a. Revenue should be recorded when payment is received because that is when the contract has been approved.

b. Revenue should be recorded when the driveway is cleared because the service has been performed. Uncollectible amounts will be accounted for as a bad debt expense.

c. Revenue should be recorded when the driveway is cleared because historically, most residents end up paying. Uncollectible amounts will be accounted for as a bad-debt expense.

d. Revenue should be recorded when payment is received because that is when the amount is known (individual or subscription-based).

Solution:

A. Correct. At the time of the service, a contract does not exist. Once the customer has agreed to pay (by doing so), they have approved the contract (and the service has already been performed).

IFRS 15.9 states, “An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations.”

In this case, one of the parties has NOT approved the contract.

B. Incorrect. While the performance obligation has been satisfied, both parties have not agreed to the terms of the contract at this point, so revenue recognition requirements have not yet been met.

C. Incorrect. While the performance obligation has been satisfied, and the collectability may be probable for most of it, both parties have not agreed to the terms of the contract at this point, so revenue recognition requirements have not yet been met.

D. Incorrect. If the other requirements of IFRS 15 are met, there is no need to wait until the amount is officially known to record revenue. P50 states, “If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.” This is not the factor preventing recognition at the time of service.

Sample question 46

Harry's Hardware Ltd. (HH) follows ASPE. HH has just recently added a new, out-of-province supplier and incurred the following costs to obtain its first shipment of inventory:

Hardware inventory $145,000

Shipping $5,000

GST $7,500

To save on shipping costs, this order was larger than usual, and HH had to temporarily lease a storage pod for $1,000.

Select the amount that should be included in the cost of inventory for this transaction.

a. $150,000

b. $151,000

c. $157,500

d. $145,000

Solution:

A. Correct. $145,000 (purchase price) + $5,000 (shipping – i.e., transport)

Because hardware is a taxable supply, the GST paid on purchases would qualify for ITCs (thus recoverable) and would not be included.

This storage is not needed before a further production stage, since HH buys finished goods, so this cost should be excluded.

ASPE3031 Costs of purchase

.12 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

.17 Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

B. Incorrect. This response incorrectly includes the storage costs.

C. Incorrect. This response incorrectly includes the GST paid on purchases that would be recoverable.

D. Incorrect. This response incorrectly omits the shipping costs.

Sample question 47

PharmaFarm Co. follows IFRS and manufactures and sells pharmaceuticals. On July 1, 2025, the company began researching a new potential product. The company began the development phase (as defined by the criteria under IFRS) on October 31, 2025.

All costs related to the new product have been tracked as follows:

Description	**Date**	**Amount**
Market research study	February 3, 2025	$28,000
Researcher salaries	July 1, 2025 – December 31, 2025	$240,000
Raw materials	July 1, 2025	$35,000
Testing	September 1 – October 31, 2025	$100,000
Raw materials	November 8, 2025	$60,000
Testing	December 9, 2025	$90,000
Information pamphlet production	December 28, 2025	$15,000

Select the amount that should be capitalized to the internally developed intangible asset account.

a. $230,000

b. $245,000

c. $525,000

d. $553,000

Solution:

A. Correct. $240,000/6 x 2 months (Nov-Dec) = $80,000 + $60,000 raw materials + $90,000 testing = $230,000.

Costs incurred before the development phase criteria have been met must be expensed per IAS 38:

54 No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

Once the development phase has been reached,

66 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

(a) costs of materials and services used or consumed in generating the intangible asset; RAW MATERIALS = OK

(b) costs of employee benefits (as defined in IAS 19) arising from the generation of the intangible asset; RESEARCHER SALARIES = OK

(c) fees to register a legal right; and

(d) amortisation of patents and licences that are used to generate the intangible asset.

IAS 38 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.

67 The following are not components of the cost of an internally generated intangible asset:

(a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use; INFORMATION PAMPHLETS

(b) identified inefficiencies and initial operating losses incurred before the asset achieves planned performance; and

(c) expenditure on training staff to operate the asset.

B. Incorrect. This response includes all expenses after October 31 (including the information pamphlets, which is incorrect).

C. Incorrect. This response includes all lab-type expenses (everything except the market research study and the information pamphlets). It ignores that the development phase wasn’t reached until October 31 and so incorrectly includes research costs incurred before that date.

D. Incorrect. This response recognizes that the information pamphlets are a selling cost that should be excluded, but it incorrectly includes the market research study and the research costs incurred before the development phase was reached.

Sample question 48

Atab has a machine (machine A) that has a carrying value of $100,000 and a fair market value of $130,000. Bata has a similar machine (machine B) that has a carrying value of $80,000 and a fair market value of $135,000. Atab and Bata, which are not related parties, agree to exchange the machines. Atab will receive machine B and will provide Bata with machine A and $5,000 in cash. Both machines are assets that produce similar products and will be used by each organization to produce goods for sale. Therefore, the estimated cash flows of each entity are not expected to change.

Select the statement that represents the entry Atab should make to record the transaction in accordance with ASPE.

a) Dr. Machine B $105,000; Cr. Machine A $100,000; and Cr. Cash $5,000

b) Dr. Machine B $135,000; Cr. Machine A $100,000; Cr. Cash $5,000; and Cr. Gain $30,000

c) Dr. Machine B $80,000; Dr. Loss $25,000; Cr. Machine A $100,000; Cr. Cash $5,000

d) Dr. Deferred Charge $5,000; and Cr. Cash $5,000

Solution:

A. Correct. ASPE 3831 – Non-monetary transactions, states:

.06 An entity shall measure an asset exchanged or transferred in a non-monetary transaction at the more reliably measurable of the fair value of the asset given up and the fair value of the asset received, unless:

(a) the transaction lacks commercial substance;

(b) the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange;

(c) neither the fair value of the asset received nor the fair value of the asset given up is reliably measurable; or

(d) the transaction is a non-monetary non-reciprocal transfer to owners to which paragraph 3831.14 applies.

.07 An entity shall measure an asset exchanged or transferred in a non-monetary transaction that is not measured at fair value in accordance with paragraph 3831.06 at the carrying amount of the asset given up (after reduction, when appropriate, for impairment) adjusted by the fair value of any monetary consideration received or given.

.11 A non-monetary transaction has commercial substance when the entity's future cash flows are expected to change significantly as a result of the transaction. The entity's future cash flows are expected to change significantly when:

(a) the configuration of the future cash flows of the asset received differs significantly from the configuration of the cash flows of the asset given up (see paragraph 3831.12); or

(b) the entity-specific value of the asset received differs from the entity-specific value of the asset given up, and the difference is significant relative to the fair value of the assets exchanged.

In some cases, a qualitative assessment will be conclusive in determining that the estimated cash flows of the entity are expected to change significantly as a result of the transaction.

The transaction lacks commercial substance, since the configuration of the future cash flows of the asset received does not differ significantly from the configuration of the cash flows of the asset given up; both machines produce similar products, which will be sold.

Therefore, the transaction should be recorded at the carrying amount of the asset given up, or $100,000 equipment + $5,000 cash = $105,000.

B. Incorrect. This uses the fair market value of the asset received.

C. Incorrect. This uses the carrying value of the asset received.

D. Incorrect. This records only the monetary portion of the transaction.

Management decision-marking and information (data) systems/technology

Sample question 49

Buckets and Twigs Inc. (Buckets) is a hockey retailer that reported the following results last year:

Sales: $1,835,000

Cost of sales: $1,255,000

Buckets is considering a 4% price increase to offset rising administrative costs. Management estimates that demand is moderately price sensitive: A 4% increase in price is expected to reduce unit sales by approximately 2%. Alternatively, maintaining current prices is expected to increase sales volume by 5% due to higher minor hockey enrolment.

Management's objective is to maintain or improve gross margin while remaining competitive.

Select the most appropriate pricing strategy.

a. Implement the 4% price increase, because the expected decrease in volume is proportionally smaller than the increase in price, supporting higher overall gross margin.

b. Maintain current prices to maximize volume growth, because higher sales volume will have a greater impact on gross margin than pricing changes.

c. Maintain current prices, because the higher expected sales volume will generate greater total revenue than the price increase strategy, leading to a higher gross margin.

d. Decrease prices slightly to further increase volume, because higher turnover will reduce average cost per unit and improve gross margin.

Solution :

A. Correct.

Last year's gross margin = $1,835,000 − $1,255,000 = $580,000

Price increase 4%, volume decrease 2%: Net revenue = $1,835,000 × 1.04 × 0.98 = $1,870,232

Cost of goods sold decrease 2%: $1,255,000 × 0.98 = $1,229,900

Gross margin = $640,332

B. Incorrect.

Gross margin increases by approximately $29,000, which is less than under the price increase option.

Revenue increase 5%: $1,835,000 × 1.05 = $1,926,750

Cost of goods sold increase 5%: $1,255,000 × 1.05 = $1,317,750

Gross margin = $609,000

C. Incorrect.

This yields a lower gross margin than under the price increase option.

Revenue under this option = $1,926,750 vs. $1,870,232 under the price increase, so revenue is higher. However, cost of goods sold also increases proportionally: $1,317,750 vs. $1,229,900.

Resulting gross margin = $609,000 vs. $640,332 under the price increase.

D. Incorrect.

While not enough detail is provided for a full analysis, it is not more profitable than other options.

For example, if prices drop 2% and volume increases 5%:

Revenue: $1,835,000 × 0.98 × 1.05 = $1,888,215

Cost of goods sold increase 5%: $1,255,000 × 1.05 = $1,317,750

Gross margin = $570,465

Sample question 50

Skyline Outdoor Gear prepares its manufacturing overhead budget using a flexible-budget model supported by its IT cost-analytics system. The static budget for the premium backpack line was based on producing 30,000 units and included the following:

- Variable manufacturing overhead: $6 per unit
- Fixed manufacturing overhead: $420,000

During the year, the IT production-tracking system shows that actual output was 24,000 units. Using the flexible-budget approach, input the flexible-budget amount for total manufacturing overhead at the actual activity level.

Solution:

$564,000. The flexible-budget variable overhead = 24,000 units x $6 per unit = $144,000. The fixed manufacturing overhead of $420,000 remains unchanged. Therefore, the total manufacturing overhead is $420,000 + $144,000 = $564,000.

Sample question 51

NorthPeak Fitness Technologies has excess production capacity for its smart resistance-training wearable devices. A large fitness studio chain offers to purchase 4,000 units as a one-time special order. The normal selling price is $450 per unit.

The following cost information is also provided: variable manufacturing cost is $210 per unit; variable selling cost is $18 per unit; fixed manufacturing cost is $120 per unit. NorthPeak has sufficient idle capacity to fulfill the order and will reduce variable selling costs by 20% if it accepts the special order.

Select the minimum acceptable price per unit for the special order.

a. $224
b. $210
c. $226
d. $222

Solution:

A. Correct. The relevant costs related to the special order are variable manufacturing costs ($210) and variable selling costs reduced by 20% ($18 x 0.80 = $14.40). Fixed manufacturing costs are not relevant to this decision because the costs will be incurred whether or not the special order is accepted.

B. Incorrect. This includes only variable manufacturing cost and ignores the (reduced) variable selling cost that is still incurred.

C. Incorrect. This is the contribution margin of the regular-priced units using variable manufacturing costs and the discounted variable selling costs ($450 - $210 - $14.40 = $226 (rounded)). This is not the price per unit.

D. Incorrect. This is the contribution margin of the regular-priced units, not the price ($450 - $210 - $18 = $222).

Sample question 52

ClearPath Inc. is a growing consulting firm winning high-profile projects. Management aims to strengthen its talent pool while maintaining an efficient hiring process. The firm recently implemented an AI-based tool that analyzes video interviews (e.g., for communication style, tone, confidence) to screen and rank candidates, reducing hiring time by 30%.

However, several candidates with strong in-person performance and exceptional reference checks were screened out by the AI tool and later hired by competitors.

Select the most appropriate action to improve the effectiveness of the AI system.

a. Incorporate additional inputs, such as reference checks and structured interview evaluations, into the AI-supported decision process.

b. Introduce a policy requiring human review of all candidates rejected by the AI system before final decisions are made.

c. Increase reliance on AI rankings by refining video interview scoring criteria to improve consistency in candidate evaluation.

d. Retrain the AI model using historical hiring data, including successful employee performance outcomes, to improve its screening accuracy.

Solution:

A. Correct. This addresses the root issue—missing qualitative data—while preserving efficiency. It aligns with both hiring quality and process objectives.

B. Incorrect. This directly addresses missed candidates but adds significant manual effort and may reduce the efficiency gains achieved by the AI system. It improves outcomes but may not scale well.

C. Incorrect. This focuses on improving an already limited input and does not address the omission of important qualitative factors.

D. Incorrect. This enhances the model's predictive capability but may still fail to capture qualitative inputs like reference checks or in-person impressions unless those factors are explicitly incorporated into the process.

Sample question 53

The product line of Oakville Limited (Oakville) includes 3 different models of a special tool to shape metal pieces. The models are named Model A1, Model B2, and Model C3. There is considerable market demand for all models of the special tool. The following are the unit selling prices and unit manufacturing costs for the 3 models:

	A1	B2	C3
Selling price	$80	$70	$60
Direct materials cost	20	20	20
Direct labour cost	20	20	10
Variable overhead cost	10	5	5
Fixed overhead cost	20	10	30

The direct labour wage rate is $10 per hour. The variable overhead cost driver rate is $5 per machine hour.

Select the production option that represents the product or products Oakville should produce in the short term if machine capacity is a constraining factor.

a. B2 and/or C3
b. A1 and/or B2
c. A1 alone
d. B2 alone

Solution:

A. Correct. When there is a capacity constraint, the contribution margin (CM) per constraining factor should be maximized in order to produce the maximum profit. In this case, the limited resource is machine hours. Therefore, CM per machine hour is calculated for the 3 products as follows:

	A1	B2	C3
Selling price	$80	$70	$60
Variable costs	50	45	35
CM per unit	30	25	25
Machine hours	10/5=2	5/5=1	5/5=1
CM per machine hour	15	25	25

Since B2 and C3 have the same CM per machine hour, Oakville should produce either or both of these products in the short term.

B. Incorrect. A1 has a lower contribution margin per machine hour, so it should not be chosen.

C. Incorrect. A1 has a lower contribution margin per machine hour, so it should not be chosen.

D. Incorrect. C3 has the same CM per machine hour as B2 and, therefore, should also be considered.

Sample question 54

Burnaby Limited (Burnaby) builds boats and other watercraft vehicles. Burnaby currently manufactures the engines for the boats. The total cost of manufacturing 200 boat engines per year is as follows:

Direct materials	$ 300,000
Direct labour	200,000
Variable manufacturing overhead	100,000
Fixed manufacturing overhead	400,000
	$1,000,000

Kelowna Inc. has offered to sell 200 engines per year to Burnaby. If Burnaby accepts this offer, the facilities it uses to produce engines can be used to produce other products. This change would save Burnaby $50,000 in rent for the leased production facility used at present to support the production of other products.

Select the amount that represents the maximum price Burnaby should be willing to pay to Kelowna Inc. for each engine.

a. $3,250
b. $2,750
c. $3,000
d. $5,250

Solution:

A. Correct. Burnaby should be willing to pay an amount equal to the costs saved by not having to produce the engines, calculated as follows:

Variable costs of manufacturing:	
Direct materials	$300,000
Direct labour	200,000
Variable manufacturing overhead	100,000
Reduction in rent due to using own space	50,000
Total savings	$650,000
Engines produced	200
Savings per engine	$ 3,250

B. Incorrect. This option excludes the variable manufacturing overhead.

C. Incorrect. This option excludes the reduction in rent due to using Burnaby's own space.

D. Incorrect. This option includes fixed manufacturing overhead, which would not be saved by not producing the engines.

Sample question 55

Grand Forks Tourists Limited (Grand) mass produces souvenir stone carvings. Grand tracks and analyzes costs through a standard costing system. In the 3 months ending December 31, 2025, Grand purchased 150,000 kilograms of stone for $300,000 and used 120,000 kilograms. Grand's standard direct material cost to produce a carving is $3.50 per kilogram, with 2 kilograms per carving. Grand manufactured 65,000 carvings during the quarter.

Select Grand's direct material efficiency variance.

a. $35,000 favourable

b. $20,000 favourable

c. $60,000 favourable

d. $105,000 favourable

Solution:

A. Correct. Calculated as follows: (65,000 × 2 – 120,000) × $3.50 = $35,000 favourable

B. Incorrect. This option uses actual direct materials cost rather than the standard direct materials cost: (65,000 × 2 - 120,000) × ($300,000 ÷ 150,000) = $20,000 favourable

C. Incorrect. This option uses the remaining inventory of stone and the actual direct materials cost: (150,000 – 120,000) × ($300,000 ÷ 150,000) = $60,000 favourable

D. Incorrect. This option uses the remaining inventory of stone (150,000 – 120,000) × $3.50 = $105,000 favourable

Sample question 56

Soft Shoe Ltd. (SSL) produces 3 lines of soccer shoes, marketed under the names Marty, David, and Usan.

Marty is top of the line, and each pair sells for $150, with variable production costs of $120. SSL produces and sells 2,000 pairs each year.

SSL annually produces and sells 1,500 pairs of David at variable production costs of $30 per pair. The shoes sell for $100 per pair.

The Usan shoes sell for $200 per pair, with variable production costs of $150. SSL produces and sells 200 pairs of this line each year.

Select the average contribution margin for SSL.

a. 35.7%

b. 38.3%

c. 55.6%

d. 64.3%

Solution:

A. Correct. The average contribution margin for SSL is calculated as follows:

	Marty	David	Usan	Total
Revenue	300,000	150,000	40,000	490,000
Variable costs	240,000	45,000	30,000	315,000
Contribution margin	60,000	105,000	10,000	175,000
As a %	20%	70%	25%	35.7%

B. Incorrect. Calculated as a straight average of product contribution margin: (20% +70% + 25%) ÷ 3 = 38.3%.

C. Incorrect. Calculated as the gross margin as a percentage of cost of sales: $175,000 ÷ $315,000 = 55.6%.

D. Incorrect. Calculated as the cost of sales as a percentage of sales: $315,000 ÷ $490,000 = 64.3%.

Non-financial reporting

The learning outcomes for this competency are the same for both Knowledge Assessment and Foundational Development. See Knowledge Assessment for samples of questions.

Strategy, risk management, and innovation

Sample question 57

Pacific Stride Running is a startup in British Columbia that manufactures premium road running shoes using materials sourced from Canadian suppliers. Due to rising inflation and increasing costs, management is concerned about the impact on long-term profitability and sustainability of relying on local suppliers. You, a CPA, have been asked to advise on appropriate risk management responses to address this risk.

Select the action that is most appropriate to manage this risk.

a. Negotiating fixed-price agreements over the next 3 years with key Canadian suppliers

b. Increasing selling prices across all product lines to offset higher input costs

c. Sourcing international suppliers to reduce dependence on domestic cost pressures

d. Investing in equipment to improve production efficiency and offset rising input costs

Solution:

A. Correct. This action directly targets the identified risk by locking in prices with key domestic suppliers, reducing exposure to inflation and cost volatility while preserving the local sourcing strategy and supporting long-term planning.

B. Incorrect. Raising prices may help recover higher costs but does not manage the underlying risk of cost volatility from local suppliers and could negatively affect demand and competitive positioning.

C. Incorrect. Shifting to international suppliers changes the risk profile rather than manages the existing local supplier risk and may introduce foreign-exchange, political, and supply-chain risks.

D. Incorrect. Improving efficiency can mitigate overall cost pressure but does not specifically address the volatility of prices charged by local suppliers for key inputs.

Sample question 58

Bonesmatter Inc. was founded a decade ago to pool medical expertise. Its mandate is to service patients with bone disorders. The company now has 100 doctors on staff and over 10,000 patients. Because many of the treatments offered to patients involve cutting-edge medical technology that by definition has not had a history of results, litigation against the doctors and the company itself is substantially higher than average. The company deals with this risk by purchasing malpractice insurance. Unfortunately, due to the high levels of litigation, the insurance company is only willing to insure Bonesmatter Inc. up to a certain level. The company self-insures for claims above this level by establishing a pool of funds it can draw on to settle claims. The amount of the pool far exceeds the total of claims against it each year.

Select the ways Bonesmatter Inc. deals with the risk of malpractice. (Select two items)

a. Transference

b. Mitigation

c. Acceptance

d. Avoidance

Solution:

A. Correct. Since Bonesmatter Inc. purchases insurance, even though the insurance company will only insure up to the ceiling amount, a part of the risk has been transferred.

B. Correct. The amounts above the insurance limit will come from a self-insurance pool funded by the company itself, and if the company's losses exceed the pool, it is responsible for them.

C. Incorrect. The size of the company's pool of funds far exceeds the total of claims against it each year, suggesting that the risk has been fully transferred and mitigated.

D. Incorrect. The nature of the business is such that the risk of malpractice is evident and significant. The business model requires that this risk be accepted and dealt with.

Sample question 59

Core Process Manufacturing (CPM) is implementing a new enterprise resource planning (ERP) system. The implementation plan includes a detailed budget, a list of required software modules, and a go-live date set for 9 months from today. The plan also includes a training schedule that begins immediately. Metrics identified to evaluate implementation progress are projected improvements in gross margin and inventory turnover after the ERP system is live. Responsibilities for implementation are assigned to the IT department.

Select the assessment that best explains the effectiveness of CPM's implementation plan.

a. The plan is ineffective because training is scheduled too early and the metrics used do not measure implementation readiness or system adoption.

b. The plan is ineffective because the go-live date is too aggressive, even though the training schedule and metrics are appropriate.

c. The plan is ineffective because, although assigning responsibilities to the IT department is sufficient, the financial metrics chosen are too detailed for an ERP project.

d. The plan is ineffective because ERP projects should not include training or performance metrics until after the system is fully operational.

Solution:

A. Correct. This assessment captures the core weaknesses of the implementation plan: Training is scheduled prematurely, before users can meaningfully learn the configured system, and metrics are tied to financial outcomes, which do not measure implementation readiness, data quality, user competence, or system stability.

B. Incorrect. The timeline may be aggressive, but the scenario provides no evidence of this. The real issues are poor sequencing (training too early) and inappropriate metrics.

C. Incorrect. Assigning responsibilities only to IT is insufficient because ERP implementations require cross-functional ownership (finance, operations, supply chain). Also, the problem with the metrics is not that they are too detailed but that they are misaligned with implementation success.

D. Incorrect. ERP projects should include training and metrics, but they must be timed appropriately and aligned with implementation milestones, not deferred until after go-live.

Tax

Sample question 60

A Canadian-resident employee earned employment income of $78,000. The employer also provided the employee with the following:

- An award for 5 years of service with the company: $900
- Employer-provided parking at the downtown office: $2,400

In addition, the following information is provided for the employee:

- RRSP contributions in the year (RRSP limit based on prior year's Notice of Assessment is $10,000): $4,000
- Union dues: $850
- Childcare expenses: $3,600
- Life insurance premiums paid by the employee: $1,200
- Charitable donations: $500

The employee is married and is the higher-income spouse in the relationship. The employee's spouse is also employed.

Select the amount that represents the employee's net income for tax purposes.

a. $76,450

b. $71,150

c. $73,150

d. $72,350

Solution:

A. Correct. Both the award for years of service and employer-provided parking are taxable benefits and added to employment income. Therefore, total employment income is $78,000 + $900 + $2,400 = $81,300.

Deductions to net income for tax purposes include RRSP contributions and union dues.

Net income for tax purposes: $81,300 - $4,000 - $850 = $76,450

Childcare expenses are claimed by the lower-income spouse.

Life insurance premiums paid by the employee are neither taxable nor deductible.

Charitable donations are a non-refundable tax credit, not a deduction.

B. Incorrect. This calculation assumes that the childcare expenses, life insurance premiums, and charitable donations are deductible in their entirety from employment income.

C. Incorrect. This calculation does not include the taxable benefits of the award for years of service and paid parking by the employer.

D. Incorrect. This calculation assumes that the childcare expenses and charitable donations are deductible in the calculation of net income for tax purposes.

Sample question 61

Cybersecurity Consulting Ltd. had accounting net income before tax of $230,000 for its 2025 fiscal year end. Additional information is provided as follows:

1) Depreciation expense is $25,000, and the maximum capital cost allowance has already been calculated and is $20,000.

2) The accounting net income includes $2,000 of life insurance premium for the president, which is required as collateral for the bank loan.

3) A bonus expense of $10,000 was recorded and accrued for accounting purposes. It was paid one month after year-end.

Select the minimum business income for tax purposes for 2025.

a. $235,000
b. $237,000
c. $245,000
d. $247,000

Solution:

A. Correct.

Net income per FS	230,000	
Add back:		
Depreciation		25,000
Deduct:		
CCA		(20,000)
Business income for tax purposes	235,000	

Because the life insurance premium for the president is required for collateral, it is deductible for tax purposes. No adjustment is required. 20(1)(e.2)

Because the bonus was paid within 180 days after year-end, it is deductible for tax purposes in the year accrued. No adjustment required.

B. Incorrect. This response adds back the life insurance premium for the president.

C. Incorrect. This response adds back the bonus.

D. Incorrect. This response adds back both the life insurance premium for the president and the bonus.

Sample question 62

Veggie Mart Ltd. is a Canadian-controlled private company (CCPC). The following information is available for Veggie Mart Ltd. for its most recent (prior) tax year:

Active business income	$1,700,000
Adjusted aggregate investment income	$240,000
Taxable income	$1,940,000
Taxable capital	$5,800,000

Select the statement that is true for Veggie Mart Ltd.'s small business deduction dollar limit.

a. It will be reduced by only the adjusted aggregate investment income grind.

b. It will be the full dollar limit available as neither grind is in effect.

c. It will be reduced by both the adjusted aggregate investment income grind and the large corporation grind.

d. It will be reduced by only the large corporation grind.

Solution:

A. Correct. As the prior year adjusted aggregate investment income (AII) is greater than $50,000, this grind is in effect.

The formula is as follows:

(D/$500,000)[(5)(E - $50,000)], where

- D = amount of the company's annual business limit for the year ($500,000 or less if shared with other companies)
- E = total of all amounts, each of which is the adjusted AII of the company or any associated company for the preceding year

B. Incorrect. The prior-year adjusted AII of $240,000 is greater than the threshold for where the grind starts ($50,000).

C. Incorrect. While the AII grind is in effect, the large corporation grind only starts when the prior year taxable capital is greater than $10,000,000 (not the case here, as it is $5,800,000).

D. Incorrect. The large corporation grind only starts when the prior year taxable capital is greater than $10,000,000 (not the case here, as it is $5,800,000). In addition, it omits the adjusted AII grind, which is in effect given the prior year adjusted AII is greater than $50,000 (at $240,000).

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A testlet is a set of objective-format questions built using a shared scenario, so that each question is answered using the same underlying information.

East Components Ltd. (35 minute testlet)

East Components Ltd. (East) is a privately held manufacturing company preparing its financial statements in accordance with ASPE. The company designs and manufactures specialized electronic components used in industrial automation systems.

You, CPA, work for McCabe LLP and are on the audit team for the East engagement.

Management provided the audit team with a related-party listing that was last updated 3 years ago. The listing includes 5 individuals and 5 entities. Since that time, the company hired a new chief operating officer (Cynthia), acquired a distribution subsidiary, and entered into a long-term supply arrangement with one new vendor.

During review of the accounts payable vendor master file, you identified multiple vendors sharing similar mailing addresses and banking information. One vendor not included on the related-party listing was Parts; East recorded purchases of $1,050,000 from that company during the year. Total purchases made by East for the year were $8,400,000.

When questioned, management stated that Parts is not a related party and asserted that similarities in vendor information were coincidental. Management reiterated that the related-party listing is complete and declined to update it, citing time constraints.

Subsequent inquiry revealed that Parts is 40% owned by Cynthia's spouse, Dylan. Dylan does not hold an operational role at East.

The purchases from Parts relate to specialized component parts developed exclusively for East under a supply arrangement entered into during the year. These components are not available from existing suppliers. Pricing is approximately 18% higher than for similar components historically purchased from other suppliers. Management insists the pricing reflects enhanced quality and reliability. No formal benchmarking or pricing analysis was performed.

In addition, a long-outstanding balance owing to Parts remains unpaid at year-end. There is no formal repayment schedule, interest has not been charged, and no written financing agreement exists. Management has classified the balance as current accounts payable.

East implemented a new accounts payable system during the year. The system does not require periodic validation of related-party designations and does not flag shared banking details or ownership overlaps between vendors.

Q1 (1 mark)

Select the statement that best reflects the most appropriate auditor response, given that inquiry reveals Parts is 40% owned by the chief operating officer's spouse.

A. Treat this as a significant risk of incomplete related-party identification and disclosure, expand procedures to independently identify related parties and relationships using external and internal sources, and escalate the matter to those charged with governance if management continues to resist updating the listing.

Correct. When audit evidence conflicts with management representations on a high-risk disclosure area, the auditor must resolve the inconsistency through expanded independent procedures. Related-party completeness is a pervasive risk affecting risk assessment, disclosure, and the evaluation of management bias and override. Escalation to those charged with governance is appropriate when management restricts access or refuses to remediate.

B. Obtain an updated management-representation letter and conflict-of-interest declaration from senior management to include Parts, then conclude on completeness if the documentation is signed and no further relationships are admitted.

Incorrect. Signed representations and declarations are lower-reliability evidence. They do not resolve contradictory indicators obtained from system analytics and ownership inquiry, especially when the issue is completeness of identification. The auditor cannot conclude completeness based solely on management's assertion after independent evidence has already contradicted it.

C. Perform procedures focusing on whether the purchases exceed planning materiality and, if not, accept management's position because any potential disclosure would not influence user decisions.

Incorrect. Related-party matters are not purely quantitative. Even if below planning materiality in dollar terms, undisclosed related-party relationships can be qualitatively material due to governance implications, fraud risk indicators, conflicts of interest, and the specific disclosure requirements that apply regardless of amount.

D. Conclude that the presence of inconsistent evidence automatically results in a scope limitation, issue a modified audit opinion, and discontinue further related-party procedures.

Incorrect. A modified opinion is not a substitute for performing available procedures. A scope-limitation conclusion is appropriate only if sufficient appropriate evidence cannot be obtained after reasonable efforts. Here, the auditor can and must expand procedures. Discontinuing them would itself constitute a failure to exercise due care.

Q2 (1 mark)

Based on the facts in the scenario, select the statement that best characterizes the management-override risk present in this engagement.

A. Management-override risk is elevated. Management’s refusal to update the related-party listing after the auditor identified the undisclosed relationship — combined with an implausible explanation of coincidence for shared banking details — is consistent with management using its authority to prevent a control from operating as intended, which is the defining characteristic of override risk.

Correct. Management override occurs when management uses its position and authority to bypass controls that would otherwise prevent or detect misstatements. Two indicators converge here: (1) The implausible coincidence explanation for objectively specific shared data (banking details and mailing addresses) signals an intent to suppress rather than investigate; and (2) the refusal to update the listing after being directly confronted with the finding means management is actively preventing the completeness control from being restored. These are behavioural indicators of override, not merely a design gap.

B. The scenario does not contain indicators of management override as there is no fraudulent intent.

Incorrect. Management override does not require proof of fraudulent intent. The defining indicator is management using its authority to prevent controls from operating as intended. Management’s refusal to update the related-party listing — after being directly informed by the auditor that an omitted relationship had been identified — is precisely this: using authority (the ability to decide whether the listing gets updated) to prevent a control from functioning.

C. Override risk exists only where there is identified financial pressure or incentive on management. Since the scenario provides no evidence of financial stress, bonus targets, or debt covenant pressure, override risk cannot be elevated on the basis of behavioural indicators alone.

Incorrect. Financial incentives are one category of fraud risk factor, but management-override risk is assessed based on behavioural indicators as well as incentive indicators. Auditing standards and professional guidance recognize that management override can occur in the absence of financial pressure — for example, to protect a personal relationship or conceal a conflict of interest, as appears to be the case here. Limiting override assessment to financial pressure alone would miss a significant category of real-world override situations.

D. Management’s refusal to update the listing is a workload-prioritization decision, not an override. Management cited time constraints as the reason, and accepting a plausible operational explanation is consistent with professional standards on management representations.

Incorrect. Professional skepticism requires that auditors critically evaluate the plausibility of management explanations rather than accepting them at face value, particularly when the explanation contradicts independently obtained evidence. The “time constraints” explanation is implausible in context: Management was directly informed of a specific confirmed omission and declined to make a single update to the listing. This is not a resourcing decision; it is a choice not to disclose a known related-party relationship, which professional standards identify as a significant override indicator.

Q3.1 (1 mark)

You inspect the agreement with Parts and related correspondence to evaluate whether the payable balance represents a genuine obligation and whether settlement is expected. Select the assertion(s) primarily being addressed by this procedure.

A. Existence and accuracy of the liability, because inspecting the agreement and correspondence tests whether a present obligation exists at the reporting date and whether the recorded amount appropriately reflects the economic substance of the liability.

Correct. When repayment terms and interest are absent, the auditor must assess whether the recorded liability represents a genuine present obligation (existence) and whether the recorded amount is appropriate given those terms (accuracy). Inspecting the agreement and correspondence provides direct evidence on both dimensions, particularly where informal terms may indicate financing characteristics or raise doubts about whether a true obligation exists.

B. Completeness of accounts payable, because the procedure evaluates whether additional unrecorded liabilities may exist under the supply arrangement.

Incorrect. Completeness addresses whether liabilities that should be recorded have been omitted. This procedure evaluates a balance that has already been recorded: It is assessing the validity and measurement of a known recorded amount, not searching for unrecorded amounts. Completeness procedures would involve steps such as reviewing unmatched invoices and performing a search for unrecorded liabilities at year-end.

C. Classification and presentation of the liability in the current portion, because the agreement terms determine whether current classification is appropriate.

Incorrect. Classification is a secondary question that depends on first establishing that the obligation exists and is properly valued. Moreover, the absence of repayment terms — not the presence of agreement terms — drives the classification assessment under ASPE 1510. The procedure's primary purpose is to evaluate what the obligation is, not where on the balance sheet to present it.

D. Rights and obligations relating to inventory acquired under the supply arrangement, because the procedure traces the components to their source agreement.

Incorrect. The rights and obligations assertion for inventory would address whether East owns the components and whether they are free from encumbrances. This procedure is directed at the liability side — at substantiating the payable arising from the related-party transaction, not at testing ownership of the inventory received in exchange.

Q3.2 (1 mark)

You obtain historical invoice data for similar components purchased from other suppliers in prior years and compare the per-unit prices to the amounts charged by Parts. Select the assertion(s) primarily being addressed by this procedure.

A. Accuracy, valuation and allocation of the liability, because comparing the related-party price to historical arm's-length prices determines whether the inventory cost and related payable are recorded at amounts that reflect what an independent transaction would have produced.

Correct. The valuation and allocation assertion addresses whether assets and liabilities include any relevant valuation or allocation adjustments. Comparing the related-party price to historical arm's-length prices is the primary available benchmark for evaluating whether the recorded amounts — inventory cost and accounts payable — are reasonable. This procedure is also the evidentiary foundation for assessing whether the exchange-amount criteria under ASPE 3840 can be met, since criterion (3) requires that terms be consistent with normal market terms and supported by independent evidence.

B. Completeness of the liability, because the pricing comparison may identify transactions where East was undercharged by the related party, suggesting unrecorded amounts owed.

Incorrect. Completeness addresses omissions: amounts that should be recorded but have not been. The pricing-comparison procedure is directed at the recorded amounts and whether they are reasonable, not at whether additional amounts exist that have been left out. An undercharge, if identified, might be a subsequent discovery, but that is not the primary purpose of performing a pricing comparison.

C. Existence of the inventory, because confirming that comparable market prices exist for similar components validates that the components themselves were genuinely acquired and delivered.

Incorrect. Existence for inventory would be addressed by physical inspection or confirmation of quantities on hand. The existence assertion asks whether assets and liabilities are real; comparing prices to historical benchmarks says nothing about whether the physical components were actually received. A vendor could charge above-market prices for components that were genuinely delivered or below-market prices for components that were not — the price comparison alone does not test whether delivery occurred.

D. Presentation and disclosure of the liability, because the pricing differential determines whether the related-party transaction must be separately described and quantified in the financial statement notes.

Incorrect. The disclosure obligation under ASPE 3840 arises from the nature of the related-party relationship, not from the magnitude of a pricing differential. The pricing comparison is not performed to determine whether disclosure is required — disclosure is required regardless.

The procedure tests whether the amounts recorded are appropriate, which is a valuation question. Any disclosure implications are a downstream consequence of that assessment rather than its primary purpose.

Q4 (4 marks)

Select the items below that should heighten the auditor's professional skepticism during the engagement. (Select 4 items.)

X Management provided explanations for anomalies that do not seem plausible to the auditor.

X A significant vendor that should have been included in the related-party transaction listing was not.

X The related-party vendor's pricing is very high compared to historical information.

X Management did not update the related-party listing after the auditor identified an error.

_ The company's offerings are specialized.

_ There are related-party purchases related to specialized component parts developed exclusively for the company.

_ The new accounts payable system has control deficiencies related to related-party identification.

_ The COO's spouse does not hold an operational role in the company.

Professional skepticism requires maintaining a questioning mind and critically evaluating the sufficiency and reliability of audit evidence, particularly in circumstances involving risk of management override or intentional misstatement. The correct items each represent a specific red flag:

1. Encountering explanations that are not plausible heightens the risk of intentional misstatement, as management may be attempting to hide information.
2. It does not seem plausible that a significant vendor and the related-party nature would not be known to management, indicating possible intentional misstatement.
3. A pricing premium creates simultaneous valuation and value-transfer risk.
4. Declining to remediate an error after being informed signals resistance rather than cooperation.

Conversely, the incorrect items do not necessarily reflect management override or international misstatement:

5. The fact that the company’s offerings are specialized simply indicates that it may be tougher to obtain audit evidence to support valuation of the products, but it does not indicate potential for management override.

6. The purchase from a related-party for a specialized part does not indicate management override but simply reflects the nature of the company’s business.

7. The accounts payable system having internal control deficiencies explains how the relationship could go undetected, but it is not itself a skepticism trigger — it does not indicate management's intent.

8. The COO's spouse having no operational role is a classification fact relevant to ASPE 3840 relationship definitions, not a condition that raises or lowers concern about management representations.

Q5 (1 mark)

Based on the indicators identified, select the statement that demonstrates at what level the auditor should assess the risk of material misstatement for the related-party completeness and disclosure assertions and provides a valid explanation.

A. Assess the risk of material misstatement as high (a significant risk) for related-party completeness and presentation, given the structural system gap, the undisclosed related vendor accounting for a significant portion of purchases, and management's refusal to update the related-party listing.

Correct. The combination of (1) a vendor master system that cannot detect shared addresses/banking, (2) an undisclosed related vendor representing 12.5% of annual purchases, and (3) management's refusal to update a 3-year-old listing despite confirmed evidence of an omitted related party indicates both a high likelihood that other related parties are missing and a potentially pervasive impact on disclosures and fraud/override risk. These are classic indicators of a significant risk for related-party completeness and disclosure that require heightened audit attention.

B. Assess the risk as moderate, because only one related vendor has been identified so far and there is no evidence that the recorded purchases or payable amounts are misstated.

Incorrect. Risk assessment is driven by the nature and pervasiveness of the control failure and management's response, not simply by the count of identified vendors or the correctness of recorded amounts. The fact that a major related vendor (12.5% of purchases) was completely omitted from a stale listing, combined with management's resistance to remediation, is inconsistent with a moderate risk assessment for completeness and disclosure.

C. Assess the risk as low, because the related vendor's purchases are quantitatively small relative to users' overall decision needs and the liability is already recorded in accounts payable.

Incorrect. Related-party completeness and disclosure risk is primarily qualitative. Even if dollar amounts were below planning materiality, undisclosed related relationships can be material due to governance concerns, fraud/override indicators, conflicts of interest, and specific disclosure requirements that apply regardless of amount. The fact that the payable is recorded does not address the risk that the relationship and its terms are not properly disclosed.

D. Do not separately assess a specific risk level for related-party completeness and disclosure. Treat the matter solely as a control deficiency to be reported to those charged with governance without changing the overall risk assessment.

Incorrect. Identified control deficiencies that affect a relevant assertion must be reflected in the assessed risk of material misstatement for that assertion.

Here, the deficiencies directly affect related-party completeness and disclosure, so they cannot be handled only as a communication to governance. Failing to revise the risk assessment would understate the true risk and could lead to insufficient further audit procedures.

Q6 (1 mark)

Under ASPE Section 3856, select the statement that explains how the Parts payable should be subsequently measured at each reporting date when it was initially measured at cost.

A. Continue measuring at cost, recognizing a reduction only if required by impairment indicators or if the instrument is subsequently modified.

Correct. When a financial instrument is initially measured at cost under the ASPE 3856 related-party guidance, subsequent measurement follows the same cost method. The carrying amount remains unchanged unless impairment indicators arise or the terms of the instrument are modified. Neither accruing interest nor remeasuring to fair value is required simply because time passes or because the balance remains unpaid.

B. Remeasure each period at fair value because the absence of stated interest indicates an embedded financing component that must be recognized through profit or loss, even in a related-party transaction.

Incorrect. Subsequent fair-value remeasurement is not automatic for a related-party debt instrument under ASPE 3856. It would only be applicable in limited circumstances — for example, if the instrument became quoted in an active market or if significant observable fair-value inputs became available, neither of which applies here. The absence of stated interest does not itself trigger fair-value remeasurement.

C. Apply amortized cost using an effective interest method by imputing a market rate of interest, because amortized cost is required whenever a liability is expected to be settled after more than one reporting period.

Incorrect. The effective interest method and imputed interest apply to arm's-length financial instruments measured at amortized cost, not to related-party instruments carried at cost under ASPE 3856. The expected timing of settlement does not change the measurement basis for a related-party instrument that was initially measured at cost; the cost model continues regardless of when settlement is anticipated.

D. Adjust the carrying amount to the higher of cost and the amount that would be due under a market interest rate, because ASPE requires related-party financial liabilities to be updated for economic substance each period.

Incorrect. There is no "higher of cost and market rate" adjustment mechanism in ASPE 3856 for related-party instruments. Such an adjustment would be specific to indexed or variable-rate instruments in particular circumstances. ASPE does not require related-party financial liabilities to be periodically adjusted to reflect market rates. The cost model is designed to be stable unless a specific triggering event — impairment or modification — occurs.

Q7 (1 mark)

Management has classified the outstanding payable to the related-party vendor as current accounts payable. Under ASPE Section 1510, select the the appropriate classification.

A. The classification as current is appropriate. Under ASPE Section 1510, a liability is classified as current when it is due on demand or when the entity does not have an unconditional right to defer settlement for at least 12 months beyond the reporting date.

Correct. ASPE Section 1510 classifies a liability as current when the entity lacks an unconditional right to defer settlement beyond 12 months. A payable with no repayment schedule is payable on demand — the creditor could call it at any time, and East would have no contractual right to defer. Current classification is, therefore, appropriate under the standard, even though the absence of terms simultaneously raises questions about the substance of the arrangement that are relevant to ASPE 3840 disclosure.

B. The payable should be classified as non-current. The long-outstanding status of the balance and the absence of any repayment schedule indicate that neither party expects near-term settlement, and non-current treatment better reflects the economic substance of the arrangement.

Incorrect. ASPE Section 1510 classification is based on contractual rights to defer settlement, not on the parties' behavioural intentions or expectations. Economic substance arguments for non-current classification are not available when the liability has no deferral right embedded in its terms. Non-current classification requires an unconditional contractual right to defer for at least 12 months, which is absent here.

C. The absence of defined terms means the balance cannot be classified until repayment terms are established, and it should be presented separately as a balance with indeterminate settlement date.

Incorrect. ASPE does not provide for a third classification category of "indeterminate" or "undetermined" obligations. Every financial liability must be classified as either current or non-current. The absence of defined terms resolves the classification question under ASPE 1510 rather than suspending it: No deferral right means no unconditional right to defer, which means current.

D. The classification depends on the auditor's assessment of whether the payable has characteristics of a financing arrangement. If the auditor concludes it does, the balance should be reclassified as long-term debt.

Incorrect. The auditor's characterization of the arrangement as having financing characteristics is relevant to ASPE 3840 disclosure requirements and to the description of the payable in the financial statement notes — it does not override the ASPE 1510 classification rules.

A payable that resembles financing but has no deferral right remains current under ASPE 1510 regardless of its economic characteristics.

Q8 (5 marks)

Under ASPE Section 3840, select the items that must be disclosed in East's financial statements in connection with the transactions and balances related to Parts. (Select 5 items.)

X The fact that Parts is 40% owned by an immediate family member of chief operating officer.

X The supply arrangement for specialized components with Parts and the total purchases of $1,050,000.

X The measurement basis applied to the Parts transactions.

X The amount outstanding with Parts at the reporting date, together with the settlement conditions: the absence of a formal repayment schedule, no interest, and no written financing agreement.

X The amounts recognized in net income during the period in connection with Parts, to the extent they differ from what would have been recognized in an arm's-length transaction.

_ The full legal name of the chief operating officer and the full corporate name of the vendor entity.

_ A calculation of related-party purchases compared to total annual purchases, presenting the $1,050,000 as a percentage of the $8,400,000 total.

_ The length of time Parts has been a vendor for East and the cumulative amounts it has purchased from East since the relationship started.

_ The fact that management did not initially identify Parts as a related party.

ASPE Section 3840 requires disclosure of (a) the nature of the relationship; (b) a description of the transactions and amounts; (c) the measurement basis; (d) amounts outstanding and their terms and conditions; and (e) amounts recognized in net income. Each of the correct items maps directly to one of these requirements.

For the incorrect answers, the nature of the relationship (criterion a) describes the type of connection, not the specific names of individuals. ASPE Section 3840 does not require naming specific individuals, which would itself raise privacy considerations. The quantitative reconciliation to total purchases is analytically useful context but is not among the enumerated disclosure requirements in the standard. The length of time Parts has been a vendor is also not a disclosure requirement. The fact that management did not initially identify Parts as a related party is an audit issue, not a disclosure issue.

Q9 (1 mark)

The specialized components purchased from the related-party vendor are used in East’s manufacturing process. The per-unit cost includes the 18% premium above historical arm’s-length prices. Under ASPE Section 3031, select the statement that explains how this premium should be recorded.

A. The premium should be included in the cost of inventory as the cost of inventory.

Correct. ASPE Section 3031 defines inventory cost as the purchase price actually paid plus directly attributable costs. There is no provision in ASPE 3031 that excludes premiums arising from related-party transactions. The standard measures cost as what was actually paid. Because the exchange-amount basis under ASPE 3840 is unavailable (criterion 3 not met), the consideration transferred — including the premium — is the measurement basis under the cost model. The lower-of-cost-and-NRV test applies at each reporting date, but NRV is not indicated to be below cost based on the facts provided.

B. The premium represents an above-market payment made in a related-party transaction and must be expensed as a period cost.

Incorrect. ASPE 3031 contains no prohibition on capitalizing amounts paid to related parties into inventory cost. There is no “excess cost” exclusion for related-party transactions in the standard. Expensing the premium as a period cost would misstate both inventory (understated) and the period’s cost of goods sold (understated, with a separate overstatement in expenses) and would have no basis in the standard.

C. The premium must be written off immediately as an impairment loss through the lower-of-cost-and-net-realizable-value test.

Incorrect. The lower-of-cost-and-NRV test is applied when there is evidence that NRV falls below carrying cost. No such evidence is present in the scenario — there is no indication that East cannot recover the cost of the components through the sale of its finished goods. Applying a writedown based on a presumption that a related-party premium will necessarily cause NRV impairment is not how ASPE 3031 operates. Impairment requires evidence, not assumption.

D. The premium should be partially included in the cost of inventory, to the extent that East can demonstrate that management’s asserted quality improvements translate into higher selling prices or reduced future production costs.

Incorrect. ASPE 3031 defines cost as what was actually paid, not as what can be retrospectively justified through quality or performance evidence. The standard does not require companies to prove that a higher purchase price generates proportionate future benefits before capitalizing it.

Management’s quality justification and the absence of benchmarking are relevant to the ASPE Section 3840 exchange amount analysis and to the audit assessment of valuation. They do not create a conditional capitalization rule under ASPE Section 3031.