

DMCL INSIGHT – New Canadian Auditing Standards



March 2011



THE IMPACT OF THE NEW CANADIAN AUDITING STANDARDS

Introduction

Existing Canadian auditing standards have been replaced with international auditing standards that will be adopted as new Canadian Auditing Standards (CASs). The CASs are effective for audits of financial statement periods ending on or after December 14, 2010.

The new auditing standards apply to audits of all entities, whether public or private, for profit or not-for-profit, large or small and in both the public and private sectors. They can be used to audit financial statements prepared in accordance with any acceptable financial reporting framework, including International Financial Reporting Standards and the new Canadian accounting standards for private enterprises.

The purpose of this newsletter is to discuss the changes in the auditor's report and the communications framework, and to outline some of the potential differences in a CAS audit from prior years.

Changes to the Auditor's Report

Content of the Auditor's Report

The audit report is noticeably longer with six required paragraphs instead of the prior three paragraphs. It is more explicit regarding the

responsibilities of management and the auditor. The new audit reporting model also deals with additional paragraphs that the auditor may add to the auditor's report:

- An "emphasis of matter" paragraph is used if the auditor considers it necessary to draw the user's attention to a matter presented or disclosed in the financial statements that is of such importance, in the auditor's judgment, that it is crucial to the users' understanding of the financial statements. It is clearly indicated in the paragraph that the auditor's opinion is not modified in respect of the matter emphasized.
- An "other matter" paragraph may be included in the auditor's report to communicate a matter other than those presented or disclosed in the financial statements, which the auditor considers relevant to the users' understanding of the audit, the auditor's responsibilities and the auditor's report.
- Auditor's who expect to add an "emphasis of matter" and/ or "other matter" paragraph to the audit report must communicate the proposed wording of the additional paragraph(s) to those responsible for the entity's governance.

Dating of the Auditor's Report

The key difference from the current standard is the requirement that the auditor's report must not be dated earlier than the date by which the auditor has obtained sufficient appropriate audit evidence to form an audit opinion on the financial statements, including evidence that:

- All the statements that comprise the financial statements, including related notes, have been prepared; and

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- Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

In Canada most Corporations Acts or other governing legislation recognizes the board of directors as having the authority to approve the financial statements. Further, such legislation may also prohibit the board of directors from delegating this power to a managing director or committee of directors. It is worth noting that National Instrument 51-102, issued by the Canadian Securities Administrators and applicable to all entities listed on a Canadian stock exchange, specifically prohibits the delegation of the approval of the annual financial statements to the audit committee or other sub-committee of the board of directors. The board of directors would demonstrate the assertion that it has taken responsibility for the financial statements by approving them at a board meeting.

Specific impacts of the change in the dating of the auditor's report include the following:

- A shorter period between completion of the audit and final release of the audit report;
- The auditor's subsequent events review will now extend to the date of the board of directors' approval of the financial statements;
- Closer coordination will be needed for the timing of the board of directors and the audit committee meetings; and
- There will be certain logistical issues and considerations over final confirmations.

Changes in the Communications Framework

Under the new standards auditors have a heightened requirement for communicating with management and those charged with governance on a timely basis. Auditors are required to establish a communications process and communicate the form, timing and expected general content.

A key CAS requirement is for the auditor to evaluate whether communications with those charged with governance have been adequate for the purpose of the audit i.e. whether the objectives of the communications have been met. Inadequate communication may indicate an unsatisfactory control environment and influence the auditor's assessment of risks of material misstatement, which in turn may necessitate additional audit procedures to support the audit opinion.

Differences in CAS audit from prior years

The nature and extent of differences that management, the audit committee and board of directors might notice depend on the circumstances of the entity. The audit process in the CAS environment as it relates to understanding the entity and its environment, risk assessments and responding to risks of material assessment is largely unchanged from the previous standards. However, the CASs contain several new or significantly changed standards that may have implications if they are relevant to the audit of your entity. Areas of potential impact include:

CAS 540: Management Estimates

CAS 540 provides more requirements than the previous standard. It focuses the auditor's work on estimates that have a risk of material misstatement and, in particular, those that have high estimation uncertainty. Auditors must perform risk assessment

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procedures specific to significant management estimates and must also review the outcome of accounting estimates made in prior periods when assessing the reliability of the current year management estimates.

CAS 550: Related Parties and Related Party Transactions (RPTs)

CAS 550 is more explicit and prescriptive in how the auditor deals with related parties and RPTs e.g.:

- The auditor now has specific communication responsibilities to those charged with governance. For example, the auditor is required to communicate with the audit committee and/ or board of directors any non-disclosure by management to the auditor of related parties or significant RPTs.
- Management and where appropriate those charged with governance will be asked to provide specific written representations with respect to related parties and RPTs.
- The auditor is required to consider the risk of fraud relating to RPTs and must document the business rationale for significant RPTs outside the normal course of operations.

CAS 570: Going Concern

The previous standards have no equivalent to CAS 570. CAS 570 requires the auditor to evaluate management's assessment of the entity's ability to continue as a going concern. When potential issues are identified, the standard requires additional procedures to be performed, including evaluating management's plans for future actions and communicating with those charged with governance.

CAS 600: Group Audits

CAS 600 has broader application than the previous standard. It applies to audits where financial information about components is included in the

financial statements being audited e.g. subsidiaries, joint ventures, equity accounted investees, branches, geographical locations etc. Under the standard the group auditor (the auditor that will report on the consolidated financial statements) is responsible for direction, supervision and performance of the group audit engagement. The group auditor will therefore be required to have more involvement in the work performed by the component auditor (an auditor who performs work on financial information related to a component of the group audit), which will likely increase the group auditor's responsibilities and level of work. There will be increased interaction between and coordination between the group and component auditors. There are specific requirements for the group auditor to communicate with the group audit committee, board of directors and management regarding such things as deficiencies in internal control that are group wide or specific to components of the entity and fraud.

CAS 320: Materiality in Planning and Performing an Audit

CAS 450: Evaluation of Misstatements Identified during the Audit

CAS 450 requires the auditor to request management to correct all the misstatements found during the audit, regardless of whether the financial statements are materially misstated. If management does not agree to post some of the proposed audit adjustments the auditor needs to gain and document an understanding for management's reasons for any unadjusted misstatements. The auditor is required to take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatements. CAS 450 also requires the auditor to communicate the effect of both prior year and current year unadjusted misstatements to those charged with governance.

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CAS 320 requires the auditor to take into account the effect of unadjusted differences on materiality and the level of audit work performed in order to reduce the risk of a material misstatement to an acceptable level. If management does not agree to posting of the proposed audit adjustments, this will likely result in additional audit work.

Conclusion

While the fundamental concepts and the purpose of the financial statement audit remain unchanged, the differences outlined in this newsletter will impact the audit process and communications for your upcoming audit. Please do not hesitate to contact your DMCL audit partner or manager, if you have any questions or concerns regarding the impact of the new CASs on your audit.

DMCL Chartered Accountants

DMCL is a leading full-service firm of Chartered Accountants located in the Lower Mainland of Vancouver, with over 120 professional and support personnel in its Vancouver, White Rock and Port Coquitlam offices. DMCL offers a full range of high-quality assurance, tax and business advisory services to clients in a wide variety of industries. DMCL is also an independent member of Moore Stephens International.

We can help!

As a reader of DMCL's Insight Newsletter, you are cautioned that the information contained herein is of a general nature and does not address specific circumstances. DMCL can help you with these or other matters that may affect your business. For details please contact your DMCL advisor.

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