

BASIS FOR CONCLUSIONS CANADIAN AUDITING STANDARDS CAS 320, Materiality in Planning and Performing an Audit, and CAS 450, Evaluation of Misstatements Identified during the Audit

September 2009

This Basis for Conclusions has been prepared by staff of the Auditing and Assurance Standards Board (AASB). It relates to, but does not form part of, Canadian Auditing Standards (CAS) 320, *Materiality in Planning and Performing an Audit*, and 450, *Evaluation of Misstatements Identified during the Audit*.

Background

In October 2006, the International Auditing and Assurance Standards Board (IAASB) issued its Exposure Draft of International Standard on Auditing (ISA) 320 (Revised and Redrafted), *Materiality in Planning and Performing an Audit*, and ISA 450 (Redrafted), *Evaluation of Misstatements Identified during the Audit* (ED-ISAs 320 and 450). The IAASB approved final ISAs 320 and 450 in June 2008 subject to confirmation by the Public Interest Oversight Board (PIOB) that due process was followed. This confirmation was received in October 2008.

In December 2006, the AASB issued its Exposure Draft to adopt proposed ISA 320 as CAS 320 and proposed ISA 450 as CAS 450 (ED-CASs 320 and 450) to replace Section 5142, MATERIALITY, and ASSURANCE AND RELATED SERVICES GUIDELINE AuG-41, Applying the Concept of Materiality. There were 8 respondents to ED-CASs 320 and 450 (identified below).

The AASB approved CASs 320 and 450 in October 2008. The Auditing and Assurance Standards Oversight Council reviewed due process followed by the AASB in the development of these CASs prior to their issuance in the CICA Handbook – Assurance.

Purpose of this Basis for Conclusions

This basis for conclusions has been prepared to make Canadian stakeholders aware of the following.

- (a) A Basis for Conclusions prepared by IAASB staff for ISAs 320 and 450 is available on the IAASB web site, and provides information on how the IAASB dealt with comments received on significant matters in response to the ED-ISAs 320 and 450.
- (b) Information on how the AASB dealt with significant matters arising from comments received in response to its ED-CASs 320 and 450 is also available. This information is set out below.

Significant Matters

AASB's Consideration of Amendments to ISA Wording

1. CASs 320 and 450 contain no amendment to the ISA wording. This is consistent with the position taken by the AASB in ED-CASs 320 and 450.

Additional Guidance

2. A respondent suggested that CASs 320 and 450 should be amended to include application and explanatory material relating to matters that are included in AuG-41. An alternative, suggested by the respondent, was to include such materials in a Guideline. However, some of the material in AuG-41 that the respondent suggested be retained is already contained in other CASs. Such materials deal with matters related to:
 - (a) accounting estimates;
 - (b) consolidated entities; and
 - (c) classification of misstatements.

A fundamental principle in developing the ISAs (and CASs) is that there should be no unnecessary duplication of guidance. Auditors are expected to read and obtain an understanding of the entire body of CASs.

3. Regarding matters in AuG-41 that are not addressed in the CASs, the AASB feels that it is not appropriate to include this level of detail in a standard. The AASB concluded that consideration will be given to providing non-authoritative guidance on matters such as:
 - (a) reduction in materiality from one period to another;
 - (b) multi-location audits;
 - (c) unverified and minimum review items; and
 - (d) the concepts of identified, likely aggregate and maximum possible misstatements, and how they interrelate.

Reporting Corrected Misstatements to Those Charged with Governance

4. A respondent suggested that the wording from ISA 450 be amended to include a requirement in CAS 450 for the auditor to communicate to those charged with governance misstatements found during the audit that management has corrected. The AASB concluded that such an amendment should not be made. CAS 450 does not prohibit such communication, and this is consistent with Section 5751, COMMUNICATIONS WITH THOSE HAVING OVERSIGHT RESPONSIBILITY FOR THE FINANCIAL REPORTING PROCESS, which states that the auditor considers such communication, and whether to do so is a matter of professional judgment for the auditor. Further, such an amendment would not meet the AASB's criteria for amendments.

Consideration of Further Possible Misstatements

5. A respondent suggested that the wording from ISA 450 should be amended to include in CAS 450 the same requirement as in the last sentence of paragraph 5142.19, which states that "consideration should be given to further possible misstatements" to ascertain whether they materially misstate the financial statements as a whole. The respondent expressed concern that the auditor may reach inappropriate conclusions about the financial statements being free of material misstatements if not required to consider further possible misstatements in all cases. The AASB concluded that the consideration of undetected misstatements by the auditor is adequately covered by paragraph 6(b) of CAS 450, which requires the auditor to determine whether the overall audit strategy and audit plan needs to be revised if the aggregate of misstatements accumulated during the audit approaches materiality, and supporting application material paragraph A5. Accordingly, the AASB concluded that no amendment should be made to ISA 450 in finalizing CAS 450 in this regard.

Offsetting Individual Material Misstatements

6. A respondent suggested that paragraph A13 of ED-CAS 450 should be amended to allow the auditor to exercise his/her professional judgment in determining whether an individual misstatement that is judged to be material can be offset by other misstatements. The AASB considered this matter and concluded that this paragraph (now paragraph A14) is appropriately worded and should be retained. It emphasizes that an individual material misstatement in the financial statements is likely to be material in the context of the financial statements as a whole and, therefore, it is unlikely that it can be offset by other misstatements.

Evaluating the Effect of Uncorrected Misstatements Related to Prior Periods

7. Two approaches, referred to as the "iron curtain" and "rollover" approaches, have been commonly used to evaluate the effect of prior period uncorrected misstatements identified by the auditor. A respondent suggested that the wording from ISA 450 should be amended to include guidance in CAS 450 stating that the iron curtain approach is not acceptable in Canada as the sole basis of dealing with uncorrected misstatements from the prior period.
8. Approaches to dealing with uncorrected misstatements from the prior period were carefully considered by the IAASB in finalizing ISA 450. The IAASB noted that there are two acceptable approaches to the evaluation of prior period uncorrected misstatements and that both approaches are applied in practice by auditors. The IAASB did not believe that, on its own, it could mandate the use of one approach over the other, because of the potential significant implications relating to a change in approach. The AASB considered this matter, including the reasons for the IAASB's decision. The AASB concluded that, following its criteria for amendments, no amendment should be made from the wording of ISA 450 in finalizing CAS 450.

Scope of CASs

9. A respondent suggested that CASs 320 and 450 should be amended to broaden its scope to include other financial information. As stated in paragraph 2 of CAS 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Canadian Auditing Standards*, the "CASs are written in the context of an audit of financial statements by an auditor. They are to be adopted as necessary in the circumstances when applied to auditors of other historical financial information."

Other Matters

None.

List of Respondents to ED-CASs 320 and 450

BDO Dunwoody LLP
Canadian Public Accountability Board
Ernst & Young LLP
KPMG LLP
Office of the Auditor General of Canada
Ordre des comptables agréés du Québec
Provincial Auditor Saskatchewan
Vérificateur général du Québec

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