

CICA handbook accounting and auditing highlight summary no. 73 March 1992

HIGHLIGHT SUMMARY

(Note: New Handbook material or changes in existing material are identified in each HANDBOOK REVISIONS RELEASE.)

Introduction to Accounting Recommendations

The introduction is amended to reflect the replacement of the Accounting Standards Committee by the Accounting Standards Board.

Reporting the effects of changing prices, Section 4510

Section 4510 has been withdrawn and being considered are the publication of a booklet summarizing the evolution of methods of reporting the effects of changing prices in Canada, and the development of guidance on the content of a management discussion of the effects of changing prices.

EIC Abstracts

- Accounting for assets contributed to a joint venture
- Dilution gains and losses in oil and gas companies using the full cost method of accounting
- Transfer of ownership of leased property
- Fully diluted earnings per share with convertible debentures classified with shareholders' equity
- Gold loans
- Distribution costs of mutual funds paid by special purpose entities
- Presentation of cash flow per share information

Introduction to Auditing and Related Services Recommendations

The introduction is amended to reflect the change in the name of the Auditing Standards Committee to the Auditing Standards Board, and to reflect changes in the Terms of Reference.

Internal control in the context of an audit, Sections 5200 to 5220

These Sections which replace existing Sections 5200 and 5220 address the auditor's consideration of internal control in the context of a financial statement audit. The most significant changes to the existing Handbook material are:

- An important amendment has been made to examination standard (ii) in GENERALLY ACCEPTED AUDITING STANDARDS, Section 5100. Previously, auditors were only required to study and evaluate those internal controls on which they subsequently relied in determining the nature, extent and timing of auditing procedures. Under the new requirements, irrespective of the audit approach used, auditors will have to obtain sufficient understanding of internal control to plan the audit. This understanding is needed to assist in identifying potential misstatements, considering factors that affect the risk of material misstatement, and determining the nature, extent and timing of auditing procedures.
- The new material reflects the risk based approach to an audit set out in MATERIALITY AND AUDIT RISK, Section 5130.
- Increased emphasis is placed on the part that an effective control environment plays in preventing or detecting material misstatements in financial statements.
- The new Handbook Sections reflect some important changes in terminology including the following:
 - "reliance on internal control" becomes "assessment of control risk below maximum";
 - "internal controls" become "policies and procedures";
 - "accounting system" becomes "control systems that collect, record and process data and report the resulting information";
 - "control procedures" become "control systems that enhance the reliability of data and information"; and
 - "compliance procedures" become "tests of controls".

These changes in terminology have been reflected in General Auditing, Sections 5000 to 5300. The changes to the remaining Auditing and Related Services Sections and Guidelines will be made in the next Handbook release.

Other important aspects of the new material are:

- The concept of internal control relevant to an audit is introduced and discussed in terms of the control environment and control systems.
- The auditor needs to understand internal control as it relates to relevant assertions related to significant account balances or classes of transactions.
- In the case of either a substantive or combined audit approach, the understanding of internal control has to encompass the control environment and control systems that collect, record and process data and report the resulting information.
- In the case of a combined audit approach the understanding of internal control also has to encompass control systems that enhance the reliability of data and information.
- The understanding of internal control has to include knowledge about the design of policies and procedures and whether they have been implemented but an evaluation of the operating effectiveness is not required.
- The understanding of internal control has to be adequately documented.
- Control risk assessments are required for relevant assertions related to significant account balances or classes of transactions.
- Control risk assessments at maximum for a specific assertion are required if policies and procedures do not address that assertion, are unlikely to be effective or if the auditor for reasons of efficiency elects not to evaluate their effectiveness.
- To support control risk assessments below maximum, sufficient appropriate audit evidence has to be obtained through tests of controls. Tests of controls are auditing procedures directed to policies and procedures within the control environment and control systems to assess their effectiveness in preventing or detecting material misstatements in financial statement assertions. Tests of controls include auditing procedures of enquiry, inspection, observation, and reperformance.
- Some auditing procedures performed to obtain the understanding of internal control may also constitute tests of controls, enabling the auditor to support control risk assessments below maximum.

The new Recommendations become effective for financial periods commencing on or after October 1, 1992. Earlier adoption is encouraged.

Reliance on the internal auditor, Section 5215

The existing Handbook material on reliance on the internal auditor has been retained and included as new Section 5215. This topic was excluded from the scope of these revisions.

Internal control letter, Section 5220

The existing Handbook material on the internal control letter has been retained and included as new Section 5220. This topic was excluded from the scope of these revisions.

Audit evidence, Section 5300

The material that addresses the need to direct substantive procedures to financial statement assertions relating to significant account balances or classes of transactions has been revised to conform to Sections 5200 to 5220.

Auditing and Related Services Guidelines

- Auditor's report on pension fund financial statements filed with a regulator

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