

CICA handbook – assurance highlight summary no. 22 June 2005

HIGHLIGHT SUMMARY

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

This Handbook release includes new and revised standards for defining the concepts of reasonable assurance and audit risk, understanding the entity and its environment, including internal control, assessing the risks of material misstatement, and designing audit procedures that are responsive to assessed risks and for audit evidence. It also includes many consequential amendments arising from the introduction of the new standards, including terminology changes. The new standards apply to all audits in Canada, for both small and large entities. The audit methodologies of some firms have, for some time, included the concepts embodied in these new standards. Other firms, however, may need to make significant changes to their audit approaches, including supporting forms, programs and checklists.

The new requirements are all to be applied at the same time and are effective with respect to financial statements and financial reports for periods beginning on or after January 1, 2006.

Reasonable assurance and audit risk, Section 5095

This new Section:

- defines the concept of reasonable assurance;
- notes that the auditor cannot obtain absolute assurance that financial statements are free from material misstatement because of various factors;
- defines the concept of audit risk; and
- permits the auditor to make separate or combined assessments of inherent and control risk.

The auditor's responsibility to consider fraud, Section 5135

This Section revises and replaces THE AUDITOR'S RESPONSIBILITY TO CONSIDER FRAUD AND ERROR, Section 5135. The scope of this revised Section, which previously dealt with fraud and error, has been narrowed to address only misstatements due to fraud. Material previously included in Section 5135 dealing with misstatements due to error, is addressed in the following new Sections:

- REASONABLE ASSURANCE AND AUDIT RISK, Section 5095;
- UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT, Section 5141;
- MATERIALITY, Section 5142; and
- THE AUDITOR'S PROCEDURES IN RESPONSE TO ASSESSED RISKS, Section 5143.

Additionally, the material formerly in Section 5135 dealing with communications matters has been moved to COMMUNICATION WITH MANAGEMENT OF MATTERS IDENTIFIED DURING THE FINANCIAL STATEMENT AUDIT, Section 5750, and COMMUNICATIONS WITH THOSE HAVING OVERSIGHT RESPONSIBILITY FOR THE FINANCIAL REPORTING PROCESS, Section 5751.

The concept of significant risk has been introduced in new Recommendation paragraph 5135.057 and in related guidance.

Understanding the entity and its environment and assessing the risks of material misstatement, Section 5141

This new Section contains new requirements for:

- understanding the entity's business risks to the extent they are relevant to the financial statements;
- understanding each component of the entity's internal controls as defined in "Internal Control — Integrated Framework" published by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission;
- obtaining an understanding of the design and implementation of controls on all audits;
- understanding an entity's risk assessment process and its monitoring of controls; and
- specifically addressing significant risks.

In addition, this new Section places more emphasis on:

- using various sources to obtain a broader understanding of the entity and its environment, including its internal control;
- supporting the assessment of the risks of material misstatement at the financial statement level and at the assertion level; and
- adhering to more rigorous documentation requirements.

Materiality, Section 5142

This Section revises and replaces MATERIALITY AND AUDIT RISK IN CONDUCTING AN AUDIT, Section 5130. The scope of this revised Section, which previously dealt with materiality and audit risk, has been narrowed to address only materiality. Audit risk is addressed in REASONABLE ASSURANCE AND AUDIT RISK, Section 5095.

The auditor's procedures in response to assessed risks, Section 5143

This new Section establishes standards and provides guidance on determining overall responses to assessed risks, and designing and performing further audit procedures to respond to the assessed risks of material misstatement at the financial statement and assertion levels.

The Section contains new requirements for specifically addressing significant risks and places more emphasis on:

- directly linking assessed risks to audit procedures that are responsive to those risks;
- performing tests of controls when the auditor has determined that evidence obtained from substantive procedures alone will not reduce risk to an acceptably low level;
- assessing whether, in certain circumstances, reliance can be placed on evidence from prior periods;
- obtaining evidence about disclosures; and
- adhering to more rigorous documentation requirements.

Audit evidence, Section 5300

This Section revises and replaces existing Section 5300 to incorporate into the Handbook, ISA 500, "Audit Evidence" with as few changes as possible to conform to Handbook references and terminology. There are no substantive changes from the material in former Section 5300.

Knowledge of the entity's business, Section 5140

This Section was withdrawn as a consequence of the issuance of UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT, Section 5141.

Internal control in the context of an audit, Sections 5200 to 5210

These Sections were withdrawn as a consequence of the issuance of UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT, Section 5141, and THE AUDITOR'S PROCEDURES IN RESPONSE TO ASSESSED RISKS, Section 5143.

Assurance and related services guidelines

New

- Applying the concept of materiality (AuG-41)

Withdrawn

- Applying the concepts of materiality and audit risk in conducting an audit (AuG-31)
- Auditing in an EDP environment (AuG-33)
- Computer-assisted audit techniques (AuG-34)
- Risk assessments and internal control — CIS characteristics and considerations (AuG-35)
- IT environments — stand-alone personal computers (AuG-36)
- IT environments — online computer systems (AuG-37)
- IT environments — database systems (AuG-38)

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