

## CHAPTER 2

### Auditors' Professional Roles and Responsibilities

#### SOLUTIONS FOR REVIEW CHECKPOINTS

##### ESSENTIALS

- 2-1. Since auditing is a critical function in the economy, it is extensively regulated to ensure it remains effective. In Canada, the regulation of professional accountants and auditors is a provincial responsibility, and varies somewhat depending on the legislation in different provinces. The profession also has a national umbrella organization that all provincial organizations are associated with. At the time of writing, the profession is being streamlined at both the national and provincial levels by uniting three formerly separate accounting designations (CA, CGA, CMA) into a single designation for Canadian professional accountants, the "CPA" (Chartered Professional Accountant). The national umbrella organization is CPA-Canada, and there are counterpart CPA associations in each province (e.g., CPA-Saskatchewan) and territory.
- 2-2. When an accountant provides auditing and assurance services for use by the general public, this is referred to as 'public accounting'. Public accounting is distinct from many other types of accounting-related work that do not produce information that the general public will use and possibly rely on, such as bookkeeping and financial statement and tax preparation for individuals or private companies. Since a person from the general public may not be able to assess whether an accountant is properly qualified and regulated to act in their best interest, to practice public accounting a person will meet higher standards than are required to do other types of non-public accounting work. Generally, a public accountant in Canada must have a CPA designation, and in many (most) provinces of Canada must obtain further qualification and licensing (e.g., in Ontario, from the Public Accountants' Council of Ontario). In the case of public accounting that involves auditing publicly-traded companies' financial statements, securities laws require the public accounting firm to be registered with the Canadian Public Accountability Board (CPAB). CPAB will inspect their financial statement audit work on public companies annually to provide the highest level of public protection, since these companies can sell their securities directly to the public.
- 2-3. Members of a CPA association are required to comply with the professional ethics code of their provincial association. Every ethics code has five similar components, requiring the member: to act with integrity; to remain objective; to maintain the professional competencies their work requires and to do their work with appropriate 'due' care; to keep confidential all information they acquire through their professional work, and; to behave professionally in a way that befits a well-respected profession.
- 2-4. In public accounting engagements, CPAs must demonstrate they can be objective by remaining independent of any potentially conflicting interests, which includes being independent in fact and also independent as it would appear to an outsider.
- 2-5. Independence in fact means the auditor maintains an objective perspective in doing his or her work - this frame of mind is essential to performing an assurance role effectively, however it is not visible (or provable) to outsiders. The auditor's independence must also be apparent to outsiders for them to believe the auditor's opinion is in fact independent. Outsiders must see evidence that the CPA has no financial or other interest that would cause them to act in a biased way, rather than in the outside user's best interest.
- 2-6. The professional ethics codes for accountants identify five situations that can arise in a three-party accountability relationship and, if they exist, can threaten an auditor's independence: self-review, self-interest, advocacy, familiarity and intimidation. An important theme here is that even in their public interest role, an auditor is still just a human being, and vulnerable to the usual human weaknesses and failings. The independence guidance

attempts to bring these potential weaknesses to light, so auditors will have a better chance of seeing when they might be failing to remain impartial. A self-review threat means the auditor is checking his/her own work; in this case s/he cannot provide the critical, independent perspective that a user (third party) would expect. With a self-interest threat, the auditor has something personal to gain and so is not free to do what is in the user's best interest - in that case his/her opinion will not meet the user's needs. With an advocacy threat, the auditor has taken a personal stand in support of the first party's positions, so they are invested in that and will have a hard time seeing objectively whether the position they publicly supported is wrong - again the auditor is not free to act in the user's best interest. With a familiarity threat, the auditor is too friendly and close to the first party and that makes it more difficult for the auditor to suspect or believe that this well-known person would do anything wrong, or act against the best interests of the third party. In the case of an intimidation threat, the auditor is facing personal risk and naturally must put their own critical interests first, before they can meet their professional responsibilities. In an intimidation threat situation, an auditor would need to seek legal advice on how best to protect him/herself without violating their professional duties.

- 2-7. Financial statement audits are required in various laws. Corporation laws require companies to produce audited annual financial statements (though private and smaller companies sometimes can waive this requirement), and securities laws require public companies to file audited financial statements within 90 days of their year end.
- 2-8. The professional ethics codes incorporate professional accounting and auditing standards, making compliance with these standards the bottom-line professional responsibility of professional accountants. CPA members meet the ethical requirements of professional competency and due care in performance their work by complying with requirements of the CPA-Canada standards for accounting (generally accepted accounting principles, GAAP, e.g., ASPE or IFRS) and auditing (generally accepted auditing standards, GAAS: CAS).
- 2-9. The overall objectives of a financial statement audit are stated in Canadian Auditing Standards (CAS) in the CPA-Canada Assurance Handbook, in CAS 200, "Overall Objective of the Independent Auditor, and the Conduct of the Audit in Accordance with Canadian Auditing Standards" CAS states a financial statement auditor's overall objectives are: (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and (b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings. CAS 200 also sets out principles and fundamental concepts that underlie the auditing function.
- 2-10. Self-regulation refers to the powers a professional group has in regulating its affairs without intervention by a government or a government established external regulator. These affairs include setting of standards, codes of conduct, education requirements, certification, and disciplining of members.

Since the failure of Enron in 2001, there has been increased involvement by outside agencies in the monitoring of the audit function. Auditing is increasingly viewed as a key pillar in capital markets, along with regulators and good governance practices. As a result external regulation of the profession has been increasing. In Canada, this has taken the form of increased monitoring of auditors of public companies via CPAB. CPAB however does not have the power to create audit and ethics standards as does the PCAOB in the U.S. Nevertheless, both CPAB and PCAOB are increasingly assertive monitoring the quality of audit practice and sanctioning auditors who do not meet their expectations. A major focus of inspections by CPAB and PCAOB is the quality of the audit. Quality generally refers to degree of conformity with standards and nature of procedures performed and their documentation. "Procedures" relate to acts to be performed. "Standards" deal with measures of the quality of performance of those acts and the objectives to be attained by the use of procedures. The standards are less subject to change. The standards provide the criteria for rejecting, accepting, or modifying a procedure in a given circumstance. An example of the relative stability of standards and procedures is found in the change from non-EDP to EDP systems. New procedures were required to audit EDP systems, but auditing standards remained unchanged and were the criteria for determining the adequacy of the new procedures.

The word "procedure" is used in SAS 46 (AU 390)--"Consideration of Omitted Procedures After the Report Date"--to refer to (1) an act to be performed and (2) sufficient competent evidence. SAS 46 speaks of omitted procedures and the relative seriousness of their omission. The importance of any "omitted procedure," however, is the evidence the auditors failed to obtain. Merely omitting technical procedures is only a superficial analysis of an audit problem; the substance is the evidence not obtained.

The standard for due audit care is the care which would be exercised by the prudent auditor. The prudent auditor is one who exercises reasonable judgment, who is not expected to be omniscient, who is presumed to have knowledge special to his profession, who is expected to be aware of his own ignorance, who is expected to possess the skills of his profession whether he is a beginner or a veteran.

- 2-11. The Canadian board (CPAB) is more self-regulatory in that the profession has more influence through having a higher percentage of board membership, the monitoring process is less public and more designed to help firms improve their practices. The CICA continues to set audit standards. The PCAOB, on the other hand, not only sets standards but also has a more confrontational and public approach in its monitoring process.

The most important difference is that PCAOB actually sets auditing and professional ethics standards for public company audits in the U.S. In Canada, audit standards are set by the CPA Canada while professional ethics standards are set by the provincial institutes/societies of CGAs, CMAs, and CAs. PCAOB reports are much more detailed disclosing the results of each inspection by firm, whereas CPAB reports are more generic providing an overall evaluation of the state of public company audits in Canada. Students generally find the PCAOB reports more interesting because they learn about problems identified for the firms they have accepted positions in. The CPAB report issued on April 3, 2012 on 2011 inspections was disappointed with the state of audits in Canada, particularly the implementation of audits in higher risk areas. "The Big 4 firms, which audit 94% of reporting issuers by market capitalization, had a GAAS deficiency rate of 20-26% on files inspected by CPAB." Other audit firms had a 47% GAAS deficiency rate. CPAB found these results consistent with other regulators. This is not just a Canadian problem.

- 2-12. CA's, CGA's, and CMA's are the old terms. They are all now CPAs and belong to CPA Canada and related provincial associations such as CPA Ontario.
- 2-13. Examples of other assurance services rendered on representations other than financial statements are on issues such as the effectiveness of internal controls, vote counts at the Academy Awards, forecasts of financial information, efficiency of public sector activities.
- Vote counts (Academy Awards)
  - Amount of prizes claimed to have been given in sweepstakes advertisements
  - Investment performance statistics
  - Characteristics claimed for computer software programs
  - Also see the list of value for money audit engagements in chapter 1.
- 2-14. The three major areas of public accounting services:  
Accounting and auditing  
Taxation  
Management advisory services (consulting)
- 2-15. The SEC site is more comprehensive but covers only the Canadian companies cross listed on U.S. exchanges.
- 2-16. "Procedures" relate to acts to be performed. "Standards" deal with measures of the quality of performance of those acts and the objectives to be attained by the use of procedures. The standards are less subject to change. The standards provide the criteria for rejecting, accepting, or modifying a procedure in a given circumstance. An example of the relative stability of standards and procedures is found in the change from non-EDP to EDP systems. New procedures were required to audit EDP systems, but auditing standards remained unchanged and were the

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- 2-18. Three elements of planning and supervision considered essential in audit practice are:
1. A written audit program.
  2. An understanding of the client's (auditee's) business.  
PA firm procedures to allow an audit team member to document disagreements with accounting or auditing conclusions and disassociate himself or herself from the matter.
  3. Ensuring that staff have appropriate training and competence to perform the audit.
- 2-19. The timing of the auditor's appointment matters because the auditor needs time to plan the audit properly and perform the work without undue pressure from too-short deadlines.
- 2-20. An auditor obtains an understanding of a client's internal control system as a part of the control risk assessment process primarily in order to plan the nature, timing and extent of subsequent substantive audit procedures. Understanding of internal control allows an auditor to gain a measure of comfort as to how much to rely on the information generated by the auditee's accounting system. A secondary purpose (not covered in Chapter 2) is to obtain information about reportable conditions (control deficiencies) to report to the client.
- 2-21. CAS 500.5(c) defines audit evidence as "Information used by the auditor in arriving at conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information." Audit evidence is (and includes) all the influences on the mind of an auditor which affect decisions about the fair presentation of propositions (financial or otherwise) submitted for audit. Evidence may be quantified or qualified; it may be objective to a greater or lesser degree; it may be absolutely compelling or only mildly persuasive to a decision.
- 2-22. The ten important elements of the standard unmodified audit report.
1. Title. The title should contain the word independent, as in independent auditor or independent accountant.
  - 2- Address. The report shall be addressed to the client, which occasionally may be different from the auditee.
  3. Notice of Audit. A sentence should identify the financial statements and declare that they were audited. This appears in the introduction paragraph.
  4. Responsibilities. The report should state management's responsibility for the financial statements and the auditor's responsibility for the audit report. These statements are also in the last paragraph.
  5. Description of the Audit. The auditor responsibilities and basis for opinion paragraphs (scope paragraphs) should declare that the audit was conducted in accordance with generally accepted auditing standards and describe the principal characteristics of an audit, including a statement of belief that the audit provided a reasonable basis for the opinion.
  6. Opinion. The report shall contain an opinion (opinion paragraph) regarding conformity with generally accepted accounting principles.
  7. Signature. The auditor shall sign the report, manually or otherwise.
  8. Date. The report shall be dated with the date when all significant field work was completed.

9. Key audit matters paragraph indicate significant judgments or uncertainties in the audit
10. Address

2-23. CPA Canada Handbook Recommendations are the highest level of authoritative support for GAAP. Textbooks and journal articles are the lowest level. In between are regulatory requirements emerging issues task force guides, Handbook Guidelines and the Conceptual Framework. Some would argue that an appropriate conceptual framework should be the highest set of principles.

2-24. Yes.  
The unmodified opinion sentence contains in the audit report implies, among other things, that the accounting principles used by the company are appropriate in the circumstances.

2-25. Four types of opinions and their messages:

Type	Message
Unmodified opinion	Financial statements are presented in conformity with GAAP.
Adverse opinion	Financial statements are not presented in conformity with GAAP.
Qualified opinion	Financial statements are presented in conformity with GAAP, except for one or more departures.
Disclaimer of opinion	Auditor's declaration that no opinion is given.

2-26. Two messages are usually implicit in a standard audit report by their absence: (1) disclosures are adequate, and (2) the accounting principles have been consistently applied.

2-27. The major differences between assurance standards and generally accepted auditing standards (GAAS) lie in the areas of practitioner competence, internal control, reporting, and suitability criteria.

GAAS presume knowledge of accounting and require training and proficiency as an auditor (meaning an auditor of financial statements). The assurance standards are more general, requiring training and proficiency in the "assurance function" and knowledge of the "subject matter of the assertions."

The assurance standards have no requirement regarding an understanding of the internal control structure for an information system. Considerations of internal control are implicit in the task of obtaining sufficient evidence. Anyway, some kinds of attested information may not have an underlying information control system in the same sense as a financial accounting and reporting system.

Reporting is different because assurance on nonfinancial information do not depend upon generally accepted accounting principles. The assurance standards speak of "evaluation suitable criteria," and "conformity with established or stated criteria" and leave the door open for assurance on a wide variety of informational assertions.

2-28. An assurance engagement is: An engagement in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion concerning a subject matter for which the accountable party in an accountability relationship is responsible.

2-29. The theoretical essence of an assurance engagement is an person's ability to recognize the information being asserted, determine the evidence relevant to the assertions, and make decisions about the correspondence of the information asserted with suitable criteria.

2-30. The assertion is that amateur golfers can drive Wilson golf balls farther than competing brands. The Wilson company is the asserter (2<sup>nd</sup> party), the PA firm is the assurer (1<sup>st</sup> party), and the amateur golfer is the 3<sup>rd</sup> party owed accountability. The criterion is the average drive by the average amateur golfer. This criterion allows objective verification with sufficient numbers of representative amateurs at high (audit) level of assurance. Critical

issues: how to define amateur golfer and the population it represents? How to obtain a representative sample of amateur golfers? What are representative golfing conditions? What is a sufficient sample size to determine the average drive with audit level assurance so that the auditor does not commit the logical fallacy of “hasty generalization”?

## SOLUTIONS TO MULTIPLE-CHOICE QUESTIONS

**MC 2-1 LO3** It is always a good idea for auditors to begin an audit with professional skepticism characterized by the assumption that

- a. a potential conflict of interest always exists between the auditor and the management of the enterprise under audit.**
- b. in audits of financial statements, the auditor acts exclusively in the capacity of an auditor.
- c. the professional status of the independent auditor imposes commensurate professional obligations.
- d. financial statements and financial data are verifiable.

**MC 2-2 LO3** When Auditee Company prohibits auditors from visiting selected branch offices of the business, this is an example of interference with

- a. reporting independence.
- b. investigative independence.**
- c. auditors’ training and proficiency.
- d. audit planning and supervision.

**MC 2-3 LO4** After the auditors learned of Auditee Company’s failure to record an expense for obsolete inventory, they agreed to a small adjustment to the financial statements because the Auditee president told them the company would violate its debt agreements if the full amount were recorded. This is an example of a lack of

- a. auditors’ training and proficiency.
- b. planning and supervision.
- c. audit investigative independence.
- d. audit reporting independence.**

**MC 2-4 LO3** The primary purpose for obtaining an understanding of the company’s internal controls in a financial statement audit is to

- a. determine the nature, timing, and extent of auditing procedures to be performed.**
- b. make consulting suggestions to the management.
- c. obtain direct, sufficient, and appropriate evidential matter to afford a reasonable basis for an opinion on the financial statements.
- d. determine whether the company has changed any accounting principles.

**MC 2-5 LO4** Which of these generally accepted auditing standards are not affected by the auditee’s utilization of a computerized accounting system?

- a. The audit report shall state whether the financial statements are presented in accordance with GAAP.**
- b. The work is to be adequately planned and assistants, if any, are to be properly supervised.
- c. Sufficient appropriate evidential matter is to be obtained ... to afford a reasonable basis for an opinion regarding the financial statements under audit.
- d. The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

**MC 2-6 LO2** Which of the following is not found in the standard unqualified audit report on financial statements?

- a. An identification of the financial statements that were audited
- b. A general description of an audit
- c. An opinion that the financial statements present financial position in conformity with GAAP
- d. An emphasis paragraph commenting on the effect of economic conditions on the company**

**MC 2-7 LO4** Assurance standards do not contain a requirement that auditors obtain

- a. adequate knowledge in the subject matter of the assertions being examined.

- b. an understanding of the auditee's internal control structure.**
- c. sufficient evidence for the conclusions expressed in an attestation report.
- d. independence in mental attitude.

**MC 2-8 LO3** Auditor Jones is studying a company's accounting treatment of a series of complicated transactions in exotic financial instruments. She should look for the highest level of authoritative support for proper accounting in

- a. provincial securities commissions' staff position statements.
- b. CPA Canada industry audit and accounting guides.
- c. CPA Canada recommendations in the *Handbook*.**
- d. Emerging Issues Committee consensus statements.

**MC 2-9 LO5** Which of the following is not an example of a quality control procedure likely to be used by a public accounting firm to meet its professional responsibilities to auditees?

- a. Completion of independence questionnaires by all partners and employees
- b. Review and approval of audit plan by the partner in charge of the engagement just prior to signing the auditor's report**
- c. Evaluating professional staff after the conclusion of each engagement
- d. Evaluating the integrity of management for each new audit client

**MC 2-10 LO3** Which of the following concepts is not included in the wording of the auditor's standard report?

- a. Management's responsibility for the financial statements
- b. Auditor's responsibility to assess significant estimates made by management
- c. Extent of auditor's reliance on the auditee's internal controls**
- d. Examination of evidence on a test basis

**MC 2-11 LO3** Which of the following is not mandatory when performing an audit in accordance with GAAS?

- a. Proper supervision of assistants
- b. Efficient performance of audit procedures**
- c. Understanding the auditee's system of internal controls
- d. Adequate planning of work to be performed

## SOLUTIONS FOR EXERCISES AND PROBLEMS

- EP2-1 a. PAs should not follow clients' suggestions about the conduct of an audit unless the suggestions clearly do not conflict with his professional competence, judgment, honesty, independence, or ethical standards. Where there is no disagreement about the results to be accomplished and the client's suggestion represents a good idea a PA can accept it. Within professional bounds, mutual agreement with the client is all right. The PA must never agree to any arrangement which violates generally accepted auditing standards or the Code of Professional Conduct.
- b. The reasons against dividing the assignment of audit work solely according to assets, liabilities and income and expenses include the following:
1. Work should be assigned to staff members by considering the degree of difficulty in relation to the technical competence and experience of individual staff members.
  2. Sequence of work performed on an examination should be in accordance with an overall audit plan.
  3. It is impossible to segregate work areas by major captions because often a close relationship exists among a number of accounts in more than one category, as for example where income is based on assets or expense is based on liabilities.
  4. Often a single audit work paper is desirable to substantiate balances in accounts of various types, such as an insurance analysis supporting premium disbursements, the expense portion and the prepaid balance.
  5. Duplication of staff effort would be more likely to occur if assignments were made on such a basis.

6. Frequently, the scope of work regarding a single account requires simultaneous participation by the staff, such as in the observation of inventories.
  7. Many audit operations are not susceptible to division by category, as for example investigating internal control, testing transactions and writing the report.
- c. The staff member whose uncle owns the advertising agency should not be assigned to examine the advertising account, even if this is the staff member that has the most detailed, in-depth knowledge of this account. The firm is responsible for avoiding any relationships which might even suggest a conflict of interest. Even if this staff member could show independence and not be biased, it still could seem as if there's a conflict of interest to outsiders. So to play it safe, it would be better to avoid this type of situation. If an issue came up down the road, it could potentially jeopardize the firm's position; therefore, any situation where a bias might exist, that situation should be avoided.

EP2-2 From a theoretical viewpoint (and, in fact, from a practical viewpoint as well) such short notice of a request for an audit causes difficulties with planning the audit work, with staffing, and with reviewing the work--all of these features being elements of the exercise of due audit care. The December 26-January 20 period is a serious time constraint for a first audit. The greatest difficulties involve the third general standard (due audit care) and the three field standards. In view of the short notice and the time constraint, there may be some question as to whether a sufficient first audit could be completed by January 20.

EP2-3 You must determine whether an unqualified opinion satisfies the GAAS reporting standard, in particular:

- a. Determine whether the financial statements are presented in conformity with GAAP.
  1. Read the footnote description of accounting policies.
  2. Use a GAAP checklist.
  3. Review the working papers for any indication of accounting policies not described in the footnote or ones apparently not in conformity with GAAP.
  4. Refer to GAAP criteria concerning the "meaning of present fairly" such as
    - (i) The accounting principles are generally acceptable, having authoritative support.
    - (ii) The accounting principles are appropriate in the circumstances.
    - (iii) The financial statements are informative.
    - (iv) The information is reasonably summarized.
    - (v) Material adjustments have not been waived without good reasons.
- b. Determine whether any accounting changes have been made and whether accounting principles have been applied consistently.
- c. Determine whether the footnote disclosures are adequate to inform users of any material information evident in the working papers.

EP2-4 GAAS in a Computer Environment

In an audit of a computer-based system, adequate training and experience must be directly related to EDP. In particular, the auditor should be knowledgeable of what computer systems do, how to test the operations of an EDP system, and how to use EDP-unique documentation.

The training and proficiency standard contributes to satisfaction of the independence standard by enabling the auditor to make his own decisions and judgments. Otherwise, he might tend to subordinate his judgment to other persons, possibly to client personnel. When the auditor lacks training and proficiency, it is virtually impossible to maintain an operational independence over audit decisions. An independence of mental attitude is futile if actual decisions are subordinated to others.

The exercise of due audit care requires a critical review at every level of audit supervision of the work done and the decisions made by auditors. Lacking the requisite skills and lacking independent decisions, the due care expected of an auditor at operational, supervisor, and review levels cannot be delivered.



The first field work standard requires adequate planning and supervision of assistants. Training and proficiency in computer systems auditing is necessary in order to plan access to computerized records, programs, and to obtain machine time for conducting audit procedures. The planning should provide for an early examination of the computer system so that further procedures involving non-computer control and accounting features may be planned should they depend upon computer control procedures.

Training and proficiency are very important for being able to obtain an understanding of the internal control structure in a computer system. Client personnel will expect audit personnel to be capable of working with a computer system.

The third standard of field work requires the auditor to obtain sufficient competent evidential matter to provide a basis for an opinion on financial statements. Documentary evidence relating to a computer system includes program flow charts, logic diagrams, and decision tables that are not normally used in non-computer systems. Since these types of documentation are a part of the evidence, they must be understood by the auditor, and understanding of them comes through training and proficiency in their use.

#### EP2-5 Audit Report Language

- a. The auditor is reporting to the body that has engaged the auditing services. While the report may be read and used by others who are indirect beneficiaries of the audit, current custom is not to address the report to the unknown class of users.
- b. The scope paragraph should specifically identify the audited statements by name so that there can be no mistake about the subject of the report. The alternative language is not as precise.
- c. The standard language effectively bases the audit on an extensive body of written auditing standards that are known to others and can be cited in case of controversy. The alternative language, on the other hand, seems to break loose from profession-wide quality norms and make the audit quality depend more on "the circumstances," which introduces an element of mystery and lack of definition into the report.
- d. The alternative wording is similar to the typical British audit report, and they seem to be able to live with it, but Canadian auditors believe that "opinion" connotes belief or judgment stronger than impression but less strong than positive knowledge. Canadian auditors do not wish to appear to have full, positive knowledge about the statements on the grounds that it's not feasible to know all there is to know about the financial statements. Also, the standard language leans heavily on GAAP as the criteria for fair presentation whereas the alternative language contains no reference to authoritative accounting criteria.

#### EP2-6 The question requires one to review and discuss the current regulatory development in the audit profession. Some points that can be discussed include:

The public accountability boards are intended to provide an additional level of independence for the public accounting function. Public concerns arose that public accountants and auditors lack independence because they are hired by and paid by the Company managers whom they are supposed to be monitoring.

Since Company managers are effectively providing their own report cards when they issue their financial statements, the audit role has value because it provides an independent assessment of the validity of the claims managers are making in their financial statements. This independent audit assessment is important to outsiders using the financial statements because it enhances the reliability of that information. Since outsiders may suspect that managers will issue biased information if left to their own devices, they demand an independent assessment of the manager's claims as this should detect any bias and require the manager to correct it. An effective independent audit function should also act as a deterrent against managers issuing biased reports in the first place. This function is referred to as monitoring. If outsiders question the independence of the auditor it cannot

provide this monitoring value.

A concern raised by some is that, if auditors lack independence, they themselves require some monitoring. It is this "monitoring the monitor" function that the public accountability boards were established to perform.

At this time, the procedures these boards will follow to monitor public accountants and auditors are still evolving. The boards may also become involved in establishing generally accepted auditing standards, quality control review standards, peer review requirements and other specific procedures that public accountants and auditors will be required to adhere to.

EP2-7 The case involves identifying a situation in which the audit scope is limited.

In situation a) the auditor has been unable to determine the impact of a contract that the client company has entered into. One means by which an auditor might determine the potential financial impact of contract would be to make inquiries of the Company's lawyer and obtain assertions from the lawyer that could be relied on.

If this is not possible, the auditor is not in a position to assess whether the contracts would have a material impact on the Company that should be included in the Company's financial statements. Here the auditor has a scope limitation that prevents providing an opinion on whether the financial statements are fairly stated as there is the possibility that the statements exclude a material liability that should either be accrued or disclosed. In this situation, the auditor has a responsibility to ensure that users are aware of the existence of the contract and the auditor's inability to assess the potential impact of contract or to obtain evidence from the Company or its lawyer regarding the potential impact. Users' decisions based on the financial statements may well be affected if they are aware that Company management is bound by a contract yet cannot provide a reasonable explanation of its impact.

In situation b) the Company is subject to regulations that can have a financial impact if violated. Determining if a violation has occurred requires scientific information. In this situation, the auditor would be required to try to determine whether any violations had occurred. Appropriate evidence would require obtaining representations from people with scientific qualifications because experts must be qualified in order for auditors to rely on their representations as evidence. In this situation, it is possible that the auditor could obtain reasonable evidence from scientific experts so no scope limitation would arise. However, similar to situation a) if the auditor is unable to obtain evidence that can confirm whether the financial impact of complying with the environmental regulation has been properly measured and reported, then the scope limitation exists and this should be noted in the audit report. Similar to situation a), users' decisions may be affected by the fact that the company is not able to provide evidence to the auditor about whether or not it is violating governmental regulations.

EP2-8 ITR's statements does not appear to be an assurance engagement, after considering the components of assurance engagements.

The parties involved are ITR and Knovel.

- These parties could be involved in an assurance engagement, with Knovel making in assertions regarding a subject matter and ITR providing assurance to third parties regarding that assertion.

The subject matter is how long it takes to recover, or "payback", the investment in Knovel's new software product.

- If the objective of the engagement is to provide assurance that this payback is three months, the assurance provider needs to obtain management's acknowledgment of responsibility for the subject matter as it relates to this objective. Since Knovel management cannot be responsible for how a purchaser of a software product implements that product to achieve operational savings and recover the investment in that product over a period such as three months, it would be difficult to identify generally accepted, appropriate criteria for assessing the subject matter in this case. This leads to the conclusion that this is not a subject matter on which an assurance can be provided in accordance with assurance standards set out by CPA Canada.

The accountability relationships would be between the Company and the assurance provider, and between each of these parties and third parties. The third parties would be potential customers that could be making decisions based on the assertion and on the assurance attached to that assertion. These accountability relationships could result in an assurance engagement.

The nature of the report that could be issued, in accordance with CPA Canada assurance standards, would be as follows:

- The report would need to identify to whom it is addressed, the objective of the assurance engagements, the entity and the subject matter covered by the engagement, management's assertion, the responsibilities of management and the assurance provider, the standards that were followed in conducting the engagement, the criteria against which subject matter was evaluated, a conclusion indicating the level of assurance being provided, the name of the assurance provider, the date and place where the assurance report was issued.

The president may have wanted the ad stopped because, effectively, the ad is providing assurance related to the claim that the Knovel software will payback in three months. Since ITR has not performed an assurance engagement, it has no basis for providing such assurance. Thus it is not appropriate to publicize this claim in a way that implies ITR is providing assurance on it.

EP2-9 The question involves the relation between GAAP and providing an audit opinion. One approach to this issue is as follows.

- a) When an auditor needs to assess whether CPA Canada *Handbook Recommendations* have been followed but the *Handbook* is silent on a particular issue, auditors usually go down a hierarchy to find the next highest source of support for the client's accounting solution to a financial reporting problem. The auditor can refer to the positions taken on accounting matters by provincial securities commissions, to accounting pronouncements issued in other countries (for example, the US Financial Accounting Standards Board or the International Accounting Standards Board), industry accounting guidelines and practices followed in financial reports of other companies in the same industry, CPA Canada EIC consensus positions, accounting research reports, textbooks, etc.

In using any of these supports, including the CPA Canada *Handbook*, to determine what is GAAP in a particular situation, the exercise of good professional judgment by the auditor is critical. In applying judgment, the auditor has to take into account the context of the situation, how the information will be used, who the users are and what their level of sophistication and access to other information is, the motives of the preparers of the accounting information, and any other relevant issues that in the auditor's experience may shed light on the reliability and appropriateness of the reported information.

Possible examples of accounting issues that may not be covered in CPA Canada *Handbook Recommendations* (current at time of writing, but note that CPA Canada *Handbook Recommendations* are updated frequently)

- revenue recognition for complex software sales that combine software and future services such as maintenance
- capitalization or expensing of environmental control equipment expenditures

- b) When the CPA Canada *Handbook Recommendations* allow for different choices of accounting methods, the auditor needs to consider whether the client's choice is appropriate in the circumstances. Again, the exercise of good professional judgment by the auditor is critical. In applying judgment, the auditor has to take into account the context of the situation, how the information will be used, who the users are and what their level of sophistication and access to other information is, the motives of the preparers of the accounting information, and any other relevant issues that in the auditor's experience may shed light on the reliability and appropriateness of the reported information.

Examples of accounting choices set out in CPA Canada *Handbook Recommendations* (current at time of writing, but note that CPA Canada *Handbook Recommendations* are updated frequently)

- revenue recognition
- amortization method
- inventory costs flow method

EP2-10 (Some instructors may prefer to defer this question until after Chapter 14 is covered.)

The case presents a scenario where events occurring subsequent to the year-end potentially have an impact on the information that should be reported in Bunting's year-end financial statements. One possible analysis follows.

One issue that is raised is the timeliness of financial reporting. By fixing a set date as of which financial statements are prepared, financial statements can become out of date before they are even issued, especially when business and economic conditions are undergoing rapid change, as is the situation in this case.

Another issue is the sensitivity of the Company's operations to information that might be reported in the financial statements. In this case, information regarding the launch of a competing product can have a harmful impact on sales contracts the company is in the process of negotiating. Here Company management is arguing that this is proprietary information and that it has to be kept private. On the other hand, the auditor believes this information has a material impact on the company's financial position and therefore it must be reported to users. The auditor might also argue that this information exists so it is very likely that potential customers are also aware of it already. By not including the impact in financial statements that are currently being prepared, the company runs the risk of giving the impression that is trying to mislead these potential customers. This can be very damaging to the company's reputation, and have very significant negative impact on its future operations. This negative impression would be aggravated by a qualified audit report which indicates that, not only was management aware of this new development, but it also refused to disclose the information even though the company's auditor was insisting on disclosure.

A further issue is the reliability of estimating the potential impact of the new product on the Bunting's future earnings. As management points out, since the product is untried in the marketplace it may well not operate as advertise. So it is a conjecture to say that its impact on Bunting's operations can be known at this time. This is difficult trade-off for the auditor to make: how should information that is highly relevant to users and their decisions but very difficult to measure reliably be handled in audit engagement? This line of reasoning would suggest that the auditor's may have gone too far in including estimated amounts and their impact on financial statement items in their audit qualification. This may explain why Bunting's management refused to accept the auditor's approach, resulting the qualified audit report.

Other valid issues based on the case facts can be identified, analyzed from different perspectives, and concluded on.

EP2-11 (Some instructors may prefer to defer this question until after Chapter 4 is covered.)

The following are some of the points that can be discussed.

Professional skepticism is required to comply with the general standard of auditing and that requires the auditor to conduct the audit with due care. Accepting management representations as being truthful without attempting to verify them by gathering relevant appropriate audit evidence is not exercising the required level of care.

The need for the auditor to rely on management representations at some point creates a conflict. Some representations are not amenable to verification using feasible audit procedures. A good example of this is the completeness representation. Management represents that it has presented complete information concerning its liabilities, its revenues, its commitments, etc. but to verify these claims is not feasible. For example, verifying completeness of liabilities would require the auditor to inquire of every possible creditor - this is impossible.

In practice this conflict is resolved some extent through the requirements of generally accepted auditing standards. In general, any management claim that can be verified by reasonable audit procedures will be verified, subject to consideration of its materiality. Representations that cannot be verified by reasonable means are

documented in management's "Letter of Representation". Further, management's responsibility for the financial statements is explained in the standard wording of the auditor's report. Also, many companies, especially public companies, include with the financial statements a "Statement of Management's Responsibility" to communicate to users management's role in preparing the financial statements and its responsibility for the assertions, accounting choices and estimates contained in those financial statements.

To the extent that these conflicts cannot ever be completely resolved, this is a limitation to the assurance that an audit can provide. Audits can never provide 100% assurance, and knowledgeable users are expected to be aware of the limitations of audits.

EP2-12 (Some instructors may prefer to defer this question until after Chapter 17 is covered.)

The question requires the application of basis assurance principles to a unique setting, United Nations weapons in Iraq. One possible response is as follows.

The subject matter is the existence of chemical, biological and nuclear weapons in Iraq.

Using the analogy of auditing for missing liabilities in a company, the Iraqi government ("management") represents that there are no hidden weapons ("unrecorded liabilities").

An approach for the assessing risks and probabilities of weapons existing.

Given the concerns of the UN about the harm that might arise from the Iraqi government possessing weapons of mass destruction, the inspectors would want to reduce the risk of missing hidden weapons to very low level. To parallel this to an audit of financial statements, this would be like setting the acceptable audit risk very low, which the auditor will do when the consequences to the auditor of missing a misstatement in the financial statements can be very costly (for example, an audit of a public company or a financial institution).

The probabilities of weapons existing is comparable to the assessment of inherent risk in a financial statement audit. Based on their resources devoted to the weapons inspection exercise and a heightened attention focused on the inspectors work and findings, it seems the UN assessed the inherent risk that weapons exist as being very high. This may have been based on internal investigations, intelligence reports or other information available to the inspectors but not public knowledge.

To implement the inspection, the inspectors would have to follow a systematic process similar to that followed by financial statement auditors.

The inspectors would need to obtain a knowledge of the types of weapons and weapon manufacturing equipment that may exist, where such weapons could be concealed, the process involved in creating such weapons and transporting them. This could be paralleled to the "knowledge of business" that the financial statement auditor requires in order to plan and execute the audit. This knowledge would inform the inspectors of the kinds of places that they need to visit and the kinds of evidence that may exist to indicate that weapons have been created or transported to a particular location. Any internal reports or other intelligence that exists concerning the use of public buildings for storing concealed weapons would also be relevant to determining the probabilities that weapons are concealed in particular locations.

A planning procedure would need to be followed to scope out the extent of the territory and existing structures and facilities that will need to be inspected and the staff required. This will determine the number of inspectors that need to be employed, the types of qualifications they require, the specific procedures they will have to perform and to estimate the time required to complete the inspection.

EP2-13 According to some recent CPAB reports PA firms seem to have most problems with meeting the independence requirements and the quality of documentation in their audit files. These problems have been ongoing for the first 10 years of the CPAB's monitoring. In part this may be why the Handbook now has a special section dealing with standards for quality control for PA firms. CPAB findings seem to increasingly influence the CPA Canada and it, in

turn, is influencing IFAC. For example, the CPA Canada at the urging of CPAB has recently created three committees to look at research and professional literature related to 1. The audit report 2. Auditor independence, including mandatory rotation of audit firms 3. The role of audit committees.

- EP2-14 One major source of the expectations gap is the public's expectations regarding auditor responsibilities to detect fraud. Discuss in class. The profession's response is discussed in chapter 7. This is a complex problem. Some questions to consider in class. How much assurance can the auditor give that management (or anyone) is honest? Should auditors provide the same assurance for detecting management fraud as for detecting lower level employee fraud? Should the auditor have responsibility only for fraud affecting the financial statements or for any fraud? Does fraud have to be a material amount, or is all fraud automatically material no matter how small the amount? It is also important to keep in mind that accusing somebody of committing fraud (or any criminal act) can lead to libel unless the accusation is proven in a court of law. In Canada's legal system an individual is considered innocent until a criminal act is proven in a court of law. These are just some of the complications in trying to close the expectations gap. For now it is sufficient for the students to get a general idea of the complexities and this can be done best through class discussion.
- EP2-15 There definitely seems to be more of an expectations gap in the private sector. Chapter 1 illustrates that public sector auditors have some of the best reputations in Canada. You cannot say the same about partners in the private sector! Some might argue that is due to the fact public sector auditors arguably have more independence than private sector auditors. See application case discussion for chapters 1 and 2. For example, when an auditor general decides which organization to audit and what type of audit (VFM? Compliance?) to perform, the auditee cannot say no! Public sector auditors have been very successful in rooting out corruption and waste and this appears to be closer to the public's image about what all auditors should be doing. See discussion in EP15. Perhaps all audits should be more like VFM audits in meeting the public's expectations. Again, surveying class attitudes at this point is a good way to get students thinking about what should be the role of auditors and comparing that to what standards actually require.
- EP2-16 Most students find that their non-accounting friends or relatives have only a vague understanding of what auditors do. Having them read the audit report does not seem to have improved matters. See discussion of answer to EP 2-15. Perhaps a more valid question is whether more sophisticated users have a better understanding.

# AUDITING

An International Approach

*Seventh Edition*

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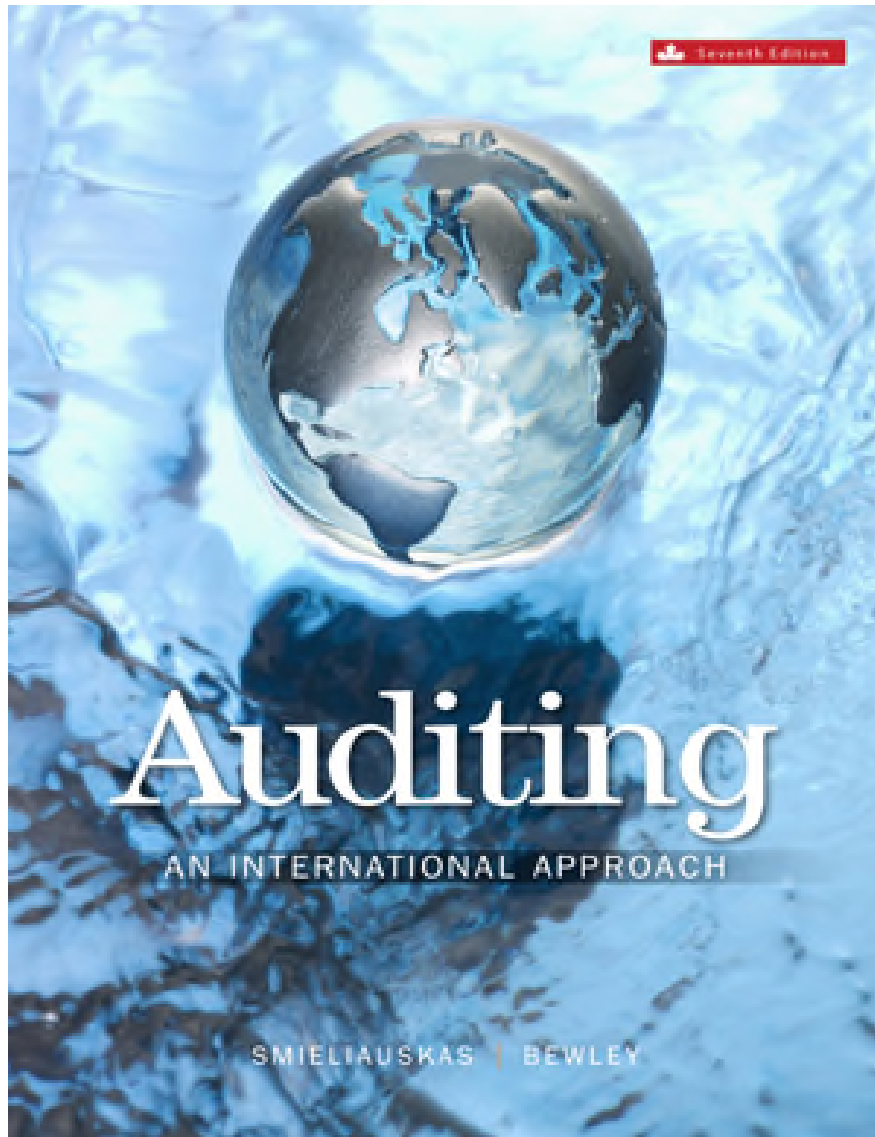
## Chapter 2

### Auditors' Professional Roles and Responsibilities

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# Learning Objectives

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- 1** Describe the current audit environment, including developments in regulatory oversight and provincial regulation of public accountants in Canada.
- 2** List the various practice standards for independent audits of financial statements.
- 3** Summarize the ethical, examination, and reporting standards that make up generally accepted auditing standards as set out in CPA Canada's Canadian Auditing Standards.





# Learning Objectives

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- 4 Explain the importance of general assurance standards using examples of assurance matters.
- 5 Explain how requirements of quality control standards are monitored for public accounting firms.
- 6 (Appendix 2A) List the generally accepted auditing standards of the United States.
- 7 (Appendix 2B) Summarize audit quality control monitoring in Canada.



# The Essentials of Auditors' Professional Roles and Responsibilities

- CPA's must also demonstrate they can be objective by remaining independent of any potentially conflicting interests, and must *maintain independence in fact* and also *independence in appearance* to outsiders.
- The ethics codes identify five situations that can arise in a three-party accountability relationship and, if they exist, can threaten an auditor's independence: self-review, self-interest, advocacy, familiarity, and intimidation.



# The Current Environment of Auditing

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- The audit environment has undergone a profound change following several spectacular corporate failures, such as Enron and WorldCom in 2002 and the economic crisis in 2008/2009.
  - As a result of these failures, the integrity of capital markets is being questioned all over the world.
  - In 2002, drastic legislation was passed in the United States.



# Sarbanes-Oxley Act (SOX)

- SOX and the financial disasters that led to it have had an impact around the world:
  - In Canada, the CPA Canada helped organize the Canadian Public Accountability Board (CPAB) to oversee auditors of public companies.
  - The Canadian Coalition for Good Governance was formed by several pension and mutual funds to monitor executives, boards of directors and auditors.



# Sarbanes-Oxley Act (SOX)

- SOX has had impact on management and auditors in the U.S., including:
  - Management certification of all its publicly issued financial information
  - Evaluation of internal control in statements made by management
  - Closer regulation of the profession, including regular monitoring of its activities
  - Greater responsibilities assigned to client audit committees
  - Increased importance of the role of the internal auditor



# Sarbanes-Oxley Act (SOX)

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- **Internal controls** gained increasing importance, as they refer to the system of policies and procedures needed to maintain adherence to a company's objectives; especially, the accuracy of recordkeeping and safeguarding of assets.
- **Audit committees** monitor management's financial reporting responsibilities, including meeting with the external auditors and dealing with various audit and accounting matters that may arise during an audit.
- **Corporate governance** describes how well a company is run in the interests of shareholders and other stakeholders.



# Self-Regulation

- Prior to 2002, the profession was largely self-regulating around the world.
  - Trust in a self-regulated audit profession changed with the U.S. corporate scandals.
  - In the U.S., the PCAOB has final authority on standards, ethics and quality control.
  - In Canada, the profession remains self-monitoring.
    - Public interests, particularly those of vulnerable third parties, must be protected.
    - Quality control standards, and CPAB monitoring implemented in recent years, helps to ensure this protection.



# Regulation of Public Accounting

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- Regulation of public accounting in Canada is a provincial matter.
  - In recent years, public accounting has been opened to all designations of accountants.
  - In addition to provincial regulations, other factors affect the profession, such as securities commissions, federal regulators and the legal environment.





# Practice Standards

- Practice standards are general guides for professional work.
  - Generally accepted auditing standards (GAAS).
  - Assurance standards.
  - General Standards of Quality Control for Firms Performing Assurance Engagements (CSQC-1).
  - Quality control standards as reflected in firm peer reviews and provincial institutes' practice inspections.



# Generally Accepted Auditing Standards (GAAS)

- GAAS identify the objectives and key principles of the financial statement audit.
  - GAAS provides a framework under which all auditing standards are applied.
  - The objectives and key principles are found in CAS 200 “*Overall Objective of the Independent Auditor, and the Conduct of the Audit in Accordance with Canadian Auditing Standards*”.



# Auditing Standards

- Auditing standards include Canadian Audit Practice Notes (CAPNs) and Audit Guidelines (AuGs).
  - **Standards** remain the same over time and for all audits.
  - **Audit Procedures** may vary based on the organization being audited (complexity, nature, and other situation-specific factors).



# GAAS: Objectives of the Audit of Financial Statements

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- The overall objective of the audit is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, with an applicable (acceptable) financial reporting framework.
  - Note how this objective implies three-party accountability.



# GAAS: General Standard

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- The auditor should comply with relevant professional ethical requirements relating to audit engagements.
  - Competence.
  - Objectivity and Independence
  - Due professional care.



# GAAS: General Standard — Competence

- Competence refers to *adequate technical training and proficiency*.
  - Competence is gained through education and on-the-job experience.
- Competence allows the auditor to:
  1. recognize underlying assertions made by management,
  2. decide which evidence is relevant to support assertion,
  3. select and perform procedures for obtaining evidence, and
  4. evaluate evidence for reality and conformity to GAAP.



# GAAS: General Standard — Objectivity and Independence

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Auditors are expected to have an objective state of mind — that is, have the characteristics of *intellectual honesty, unbiased and impartial*.

This is achieved by maintaining independence.

- Independence in fact is the mental attitude, or state of mind of the auditor.
- Independence in appearance is covered by rules of professional conduct.



# GAAS: General Standard — Due Professional Care

- Due professional care requires *observance of the rules of professional ethics and GAAS*.
  - competent and independent, exercise proper care in planning and supervising the audit, understanding the auditee's control structure, and obtaining sufficient appropriate evidence
- Due care is best understood in the context of the prudent auditor.
  - Due care is a matter of what competent auditors do and how well they do it.
  - Determination of due care must be reached on the basis of facts and circumstances in the case.
  - Due care is frequently at issue in legal suits.





# GAAS: Examination Standards

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- These standards set the quality criteria for conducting an audit.
- The standards also relate to the sufficiency and appropriateness of evidence gathered to support the audit opinion.



# GAAS: Examination Standards — Conduct and Scope

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- The auditor should ***conduct an audit*** in accordance with Canadian Audit Standards (CASs) and the CAPNs.
- In determining the audit procedures to perform in accord with CAS's “***scope of an audit,***” the auditor should comply with each CAS relevant to the audit.



# GAAS: Examination Standards — Reasonable Assurance and Audit Risk

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- The auditor should obtain ***reasonable assurance*** that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error.
  - a degree of confidence of 90%–99% confidence would be normal. 95% confidence is the most common degree of confidence.
- The risk that an auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is ***audit risk***.



# GAAS: Examination Standards — Planning and Supervision

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- The auditor should ***plan and perform an audit*** to reduce audit risk to an acceptably low level that is consistent with the objective of an audit.
  - The risk that an auditor expresses an inappropriate audit opinion when the financial statements contain material misstatement is audit risk.



# GAAS: Examination Standards — Planning and Supervision

- CAS 300 contains several considerations for planning and supervision of an audit.
  - Preparing an audit program and supervising the audit work.
  - Obtaining knowledge of the auditee's business.
  - Dealing with differences of opinion among the audit firm's own personnel.



# GAAS: Examination Standards — Planning and Supervision

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- A written audit program is desirable.
  - The audit program is a list of procedures the auditor will need to perform to complete the audit.
- Understanding of the client's business is an absolute necessity.
  - The auditor must understand the events, transactions and practices that will have an effect on the financial statements.



# GAAS: Examination Standards — Planning and Supervision

- Auditors on the audit team may not always agree on audit decisions.
  - Procedures for documenting dissent, and for resolving disagreement need to be established.
  - The basis for the final audit decision needs to be documented in the working papers.



# GAAS: Examination Standards — Planning and Supervision

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- Timing is important consideration in audit planning.
  - Audit planning needs to begin well before the client's fiscal year-end.
  - Some audit procedures can be conducted at an interim date, a date weeks or months before the fiscal year-end.
    - This allows the auditor to make adjustments to make the year-end audit more efficient.





# GAAS: Examination Standards — Internal Control Assessment

- Examination standard CAS 315.12-23 requires an understanding of the auditee's internal control.
  - This consists of a company's control environment, accounting system, and control procedures.
- Good internal control reduces the probability of errors or irregularities in the financial statements.
  - Internal control is a system's capability to prevent or detect material data processing errors or fraud and provide for correction on a timely basis.
  - Understanding internal controls is the foundation for assessment of control risk.



# GAAS: Examination Standards — Sufficient Appropriate Evidential Matter

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- CAS 200 requires auditors to obtain enough evidence to justify opinions.
  - Appropriate evidence is both *reliable* and *relevant*.
  - The standards require *sufficient*, not absolute, evidence.



# GAAS: Reporting Standards

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- The report should identify the financial statements and distinguish between the responsibilities of management and the responsibilities of the auditor.
- The auditor should determine whether the financial reporting framework adopted by management in preparing the financial statements is acceptable.



# GAAS: Reporting Standards

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- The auditor should refer to CASs 700 and 705 when expressing an opinion on a complete set of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to achieve fair presentation.



# GAAS: Reporting Standards — Standard Unmodified Opinion Report

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- **Unmodified opinion** audit report — good, as the auditor is not calling attention to anything that may be wrong in the statements; there are no reservations.
  - Auditing standards dictate use of a standard report.
- **Modified opinion** audit report — bad, as the auditor reports a departure from GAAP, or a limitation in the scope of the audit.



# GAAS: Reporting Standards — Standard Unmodified Opinion Report

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- The standard unmodified contains a number of features, as well as a standard wording.



# The Standard Report

## 1. Title

The Independent Auditor's Report on  
a Complete Set of General Purpose  
Financial Statements

## 2. Address

To the Shareholders of .....



# The Standard Report

## 3. Introductory Paragraph in the Opinion Section

### Opinion

We have audited the accompanying financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity, and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.





# The Standard Report

## 4. Opinion Paragraph in the Opinion Section

### Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).



# The Standard Report

## 4. Basis for Opinion

### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Provincial Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants together with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



# The Standard Report

## 5. Key Audit Matters

### Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion, thereon, and we do not provide a separate opinion on these matters.

*[Description of each key audit matter in accordance with CAS 701.]*



# The Standard Report

## **6. Management and corporate governance responsibilities**

### **Responsibilities of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.



# The Standard Report

## **6. Management and corporate governance responsibilities**

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going-concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.



# The Standard Report

## 7. Auditor's Responsibilities and Description of the audit

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with CASs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

*[Additional description of auditor responsibilities is required here, or referenced to an appendix to the report, or reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities.]*



# The Standard Report

**8. Signature**

City

(Signed)

**9. Date**

Date

Public Accountant

**10. Auditor's  
Address**

[Auditor Address]



# Generally Accepted Accounting Principles (GAAP)

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- The auditor's opinion reflects accordance with Canadian GAAP.
  - GAAP can come from a variety of sources.
  - The auditor's opinion implies
    - Accounting principles used are generally accepted
    - Accounting principles used are appropriate
    - Statement and notes are informative
    - Classification and summarization is appropriate
    - Statements are accurate within materiality





# Consistency

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- No reference to consistency is made in the unmodified audit report where no accounting changes had been made, or when changes are properly disclosed.



# Adequate Disclosure

- The audit opinion also implies that there is adequate disclosure of all the important accounting information users need.
  - Evaluating disclosure requires significant exercise of professional judgment.
  - Lack of disclosure is a departure from GAAP and may require a modified audit report.



# Report Content

- Report shall contain either an expression of opinion or an assertion that an opinion cannot be expressed.
  - Opinion could be **unmodified**, **modified**, or **adverse**.
  - A **disclaimer of opinion** is an auditor's declaration that no opinion is given.
  - An explanation is required whenever there is a report reservation.



# Assurance Standards

- An assurance engagement:
  - “An engagement where, pursuant to an accountability relationship between two or more parties, a practitioner is engaged to issue a written communication expressing a conclusion concerning a subject matter for which the accountable party is responsible.”
    - *CPA Canada Handbook, section 5025.*

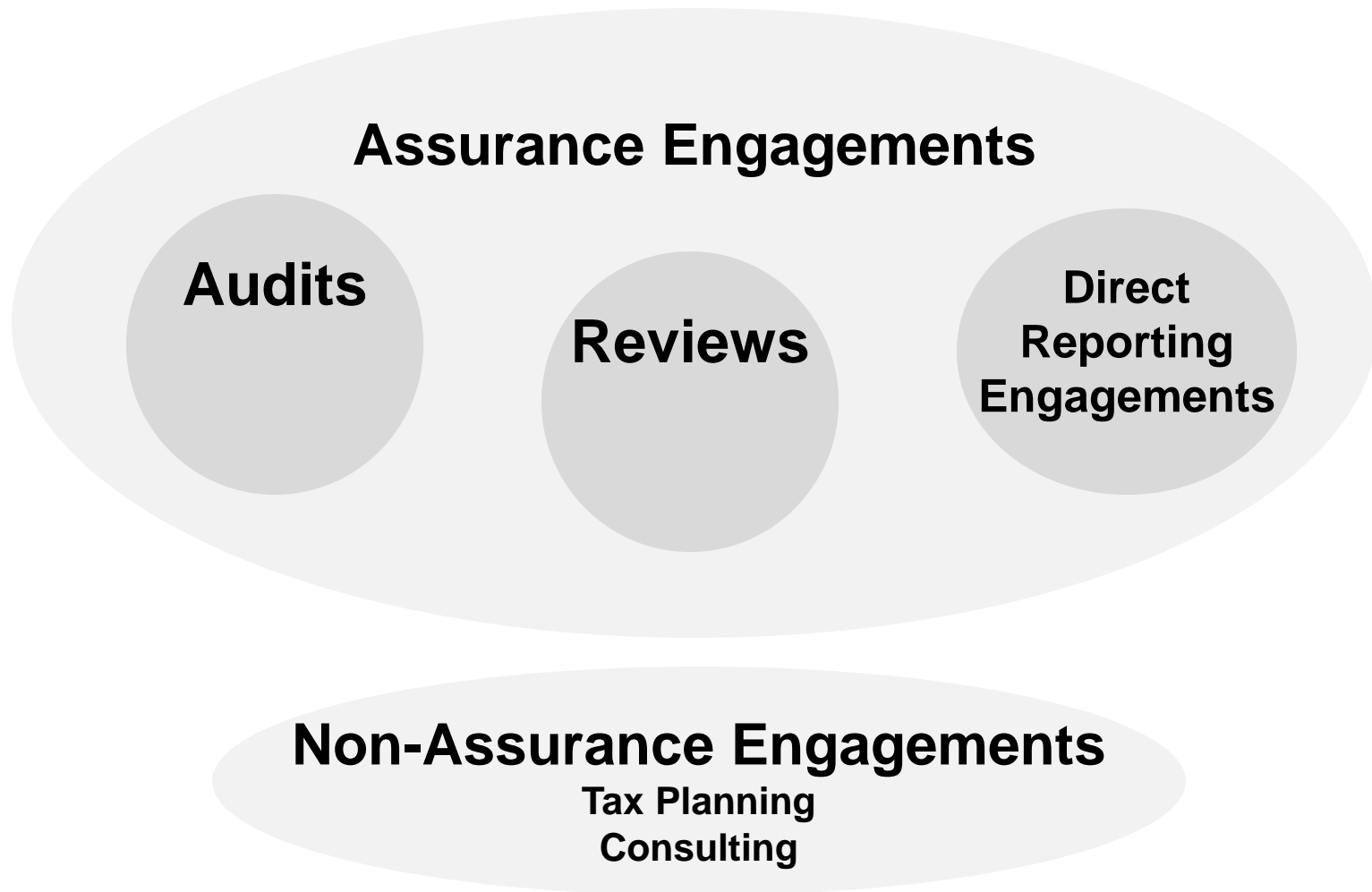


# Assurance Standards

- Assertion: A statement about some aspect of a subject matter.
- Assurance standards can be applied to written and unwritten assertions.
  - Unwritten — direct reporting engagements
  - Written — attest engagements
    - Audits and reviews are considered attest engagements.

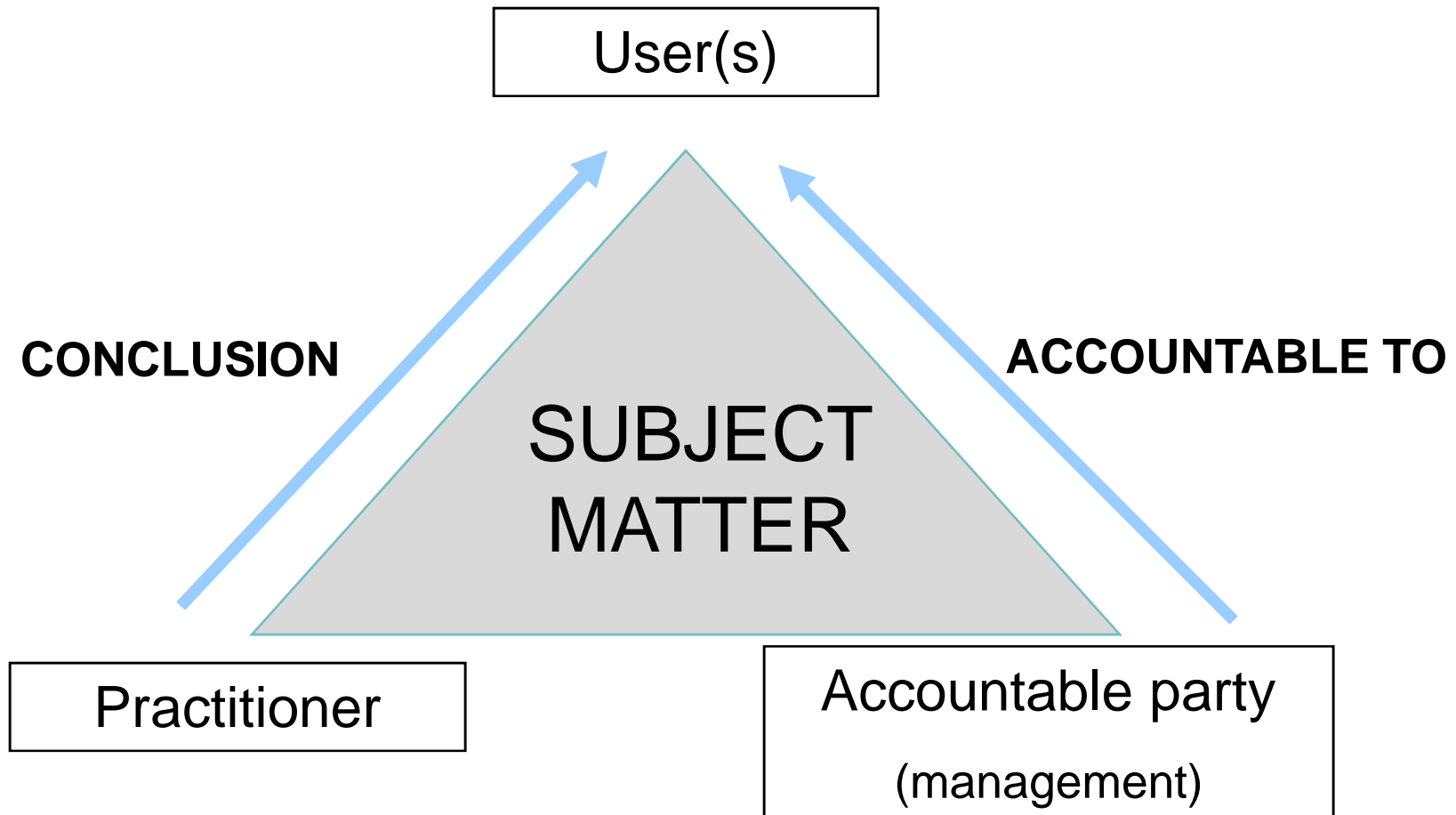


# Chartered Professional Accountant Engagements





# Three Parties Involved in an Assurance Engagement





# Assurance Standards

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- The assurance standards were created after GAAS, and ideas from GAAS were borrowed for the assurance standards.
  - Major differences arise in the areas of:
    - practitioner competence
    - internal control evaluation
    - reporting
  - Assurance standards are more general than GAAS.





# Quality Control Standards

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- Quality control:
  - Actions taken to evaluate compliance with professional standards as defined in the CPA Canada Handbook and provincial rules of professional conduct.
  - Several frameworks for quality control are available.



# Elements of Quality Control

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- Quality control frameworks have been developed by CPA Canada, the IFAC, and by the AICPA.
  - Quality control in audit firms has received considerable attention in recent years.



# Accountability Boards Quality Control

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- Accountability boards have introduced new rules geared to improving auditor independence including:
  - Five year rotation of partners
  - Strict limits on consulting services that have the potential to cause conflicts of interest with the auditing role.



# Monitoring of Quality Control

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- Practice inspection, peer review and quality reviews are “audits of the auditors.”
  - Practice inspections review and evaluate the audit files and documentation.
  - Quality inspections are evaluations of the quality of the overall practice of the PA.
  - Peer review is a practice inspection done by one PA engaged by the firm to be reviewed.



# End of Chapter 2

