

CHAPTER 1 – INTRODUCTION TO AUDITING

Auditing

Verification of information by someone other than one providing it

- Used to **reduce risk** that decision based on accounting information will be inaccurate
- Auditor **hired by shareholders**, not management

Objective of an Audit

- **Enhance** degree of **confidence** of intended users in F/S **through** auditor **verifications**

Three party accountability

Accountability relationship in which there are three distinct parties

Parties	Roles	Description of Roles
Asserter	Management	Prepares F/S and makes assertions about them
Assurer	Auditor	Independent assertion of F/S to lend credibility to them
Users	Stakeholders	Users of the information in F/S presented

Agency theory

- If **managers unchecked**, use **more resources** than optimal and incentive to **report misleading info** about performance to owners

Expectation GAP

- **Difference between** what **auditor provides** and what **public expects** auditor to provide

Risk

Business risk

Significant conditions, events, circumstances, actions which might **adversely affect** entity's ability to **achieve objectives** and **execute strategies**

Information risk

F/S will **fail** to appropriately **reflect economic substance** of business activities, including business risk and uncertainties

Risk components	Description & Scope
Audit Risk	Risk that material misstatement will remain undiscovered after audit is complete
Accounting Risk	Uncertainty and judgement involved in certain accounting records & transactions

Materiality

- Amount of **misstatement** which is likely to **affect decision making** of users

Types of Audits

Types	Description
Internal & Operational	<ul style="list-style-type: none">• Internal auditors independent from management, but report to VP finance• Evaluate company's risk management & controls and provide recommendations
Audit of F/S	Verification of information, provided by management, by external auditor
Public Sector (gov.)	<ul style="list-style-type: none">• Auditor General of Canada verifies efficient use of public funds• Audit management of government programs & income tax returns
Other	Includes fraud, IT, environmental, compliance, etc.

Types of Service

Types	Services Offered
Assurance	Audit of F/S; Reviews of F/S; Report on effectiveness of internal controls; IT attestation services
Consulting (non-assurance)	Compliance engagement; Tax services; Consulting/Management advisory services; Compilation of F/S

CHAPTER 2 – AUDITORS' PROFESSIONAL ROLES AND RESPONSIBILITIES

Canadian Public Accountability Board (CPAB)

- **Monitors auditors** of **public companies** in Canada by doing annual **inspections** and providing **sanctions** as needed

Accounting Profession (CPA)

- **Creates** actual **auditing standards** and adopted International auditing standards in Canada (CAS – Canadian Auditing Standards)

Provincial Regulation

Regulatory Bodies	Description & Purpose
Provincial Securities Commission	<ul style="list-style-type: none"> Formulate financial reporting policies Monitor application of accounting principles and auditing standards
GAAS (Generally Accepted Auditing Standards)	<ul style="list-style-type: none"> Includes CAS Includes other standards (Canadian Audit practice statements CAPS; Audit Guidelines AuGs)
CAS 200 - 810 (36 Canadian Auditing Standards)	For audits of F/S and other historical financial information
CSQC1 (1 Canadian Standards on Quality Control)	<ul style="list-style-type: none"> For audits and other assurance engagements To be read in conjunction with rules of professional conduct and code of ethics
OCS (Other Canadian Standards)	Contain standards and guidance for other engagements (e.g. reviews)

Ethical Standards

Standards	Description & Scope
<i>Competence</i>	<ul style="list-style-type: none"> Having adequate technical and on the job training Using judgement Using professional scepticism
<i>Objectivity & Independence</i>	<p>Having independence in fact (no bias) and appearance (public perception of auditor's relation with client)</p> <p><u>Threats to independence</u></p> <ol style="list-style-type: none"> Self-interest Benefitting from financial interest in a client Self-review Providing assurance on own work Advocacy Promoting client's position or opinion Familiarity Becoming too sympathetic to client's interests Intimidation Being deterred from acting objectively by threats from a client
<i>Due Care</i>	<ul style="list-style-type: none"> Proper understanding of client's business, internal controls and risks Proper planning and supervising of audit Obtaining sufficient and appropriate evidence

Commercialism vs Professionalism

- Where the **business needs** of an audit firm are **balanced** against the **public interest**
 → Auditors must be aware of any **potential conflicts** of interest and ensure it does **not impair** their **audit** quality

Auditor Responsibilities

Categories	Description of Responsibilities	
CAS 200 Overall Objectives	<ul style="list-style-type: none"> Obtain reasonable assurance about if F/S free from material misstatements Express opinion on if F/S prepared in accordance with accounting standards Report on F/S in according with auditor's findings 	
CAS 210 Preconditions of an Audit	<ul style="list-style-type: none"> Determine if financial reporting framework applied is acceptable Obtain agreement of management that it acknowledges and understands its responsibility (Audit engagement letter) 	
CSQC1 Quality Control System implemented by Auditor	<ul style="list-style-type: none"> Procedures & policies used to make sure audit firm meets professional responsibilities and complies with GAAS on every audit 	
<i>Material Misstatements</i>	<i>Errors (unintentional)</i>	<ul style="list-style-type: none"> Auditor must apply risk based approach, proper methodologies and audit tests If material error found, ask client to fix it; if not corrected, issue qualified audit report
	<i>Fraud & other irregularities (intentional)</i>	<p><u>Fraud involves the following 3 components (fraud triangle)</u></p> <p>1) <i>Incentive/pressure to commit fraud</i> 2) <i>Perceived opportunity to do so</i> 3) <i>Rationalization of the act</i></p> <p><u>Types of Fraud</u></p> <p><i>Employee</i> - misappropriation of assets <i>Management</i> - fraudulent financial reporting</p> <ul style="list-style-type: none"> Auditor must evaluate likelihood of fraud Primary responsibility for prevention & detection of fraud rests with management

System of Quality Control (SQC)

Elements	Description of Elements
1. Leadership responsibilities within firm	Promote internal culture of recognizing quality as essential in performing engagements
2. Relevant ethical requirements	<ul style="list-style-type: none">Establish procedures to maintain independenceIdentify and evaluate threats to independenceTake appropriate actions to eliminate/reduce those threats to an acceptable level
3. Acceptance and continuance of clients	Establish procedures for client acceptance and continuance
4. Human resources	<ul style="list-style-type: none">Sufficient personnel with competence, capabilities, and commitment to ethical principlesAssign responsibility for each engagement to partnerEstablish procedures to assign appropriate personnel to each engagement
5. Engagement performance	<ul style="list-style-type: none">Define supervision responsibilities and review responsibilitiesDefine engagement-level quality control review for all audits of listed entities and other significant engagements
6. Monitoring of audit firm SQC	<ul style="list-style-type: none">Establish monitoring process to provide reasonable assurance that quality control procedures are relevant, adequate, and operating effectivelyEvaluate effect of deficiencies noted as result of monitoring process and take necessary corrective action

Management Responsibilities

Responsibilities	Description of Responsibilities
Prepare F/S	Prepare F/S in accordance with applicable financial reporting framework (ASPE/IFRS)
Design Internal Controls	Design internal controls necessary to prepare F/S free from material misstatements
Provide Auditor with...	<ul style="list-style-type: none">Access to all relevant informationUnrestricted access to persons within entity
For publicly listed firms...	<ul style="list-style-type: none">CEO and CFO must certify F/S and MD&AManagement and auditor responsibilities are summarized in the audit report

Audit Report

Opinions	Description of Opinions
Unqualified	When F/S are free of material misstatements
Qualified	Significant, but not pervasive, GAAP departure or scope limitation
Adverse	There is pervasive GAAP departure
Denial	No opinion issued because auditors unable to conclude (pervasive scope limitation)

CHAPTER 5 – PRELIMINARY AUDIT PLANNING: UNDERSTANDING THE AUDITEE'S BUSINESS

Client Acceptance

➤ There is **no obligation** or requirement for a firm to **accept** undesirable **clients**, nor to retain existing ones

Steps	Description
1. Obtain & review financial information	Obtain and review financial info about prospective auditee organization to determine purpose and main users of F/S and basis of accounting being used
2. Evaluate public accounting firm	Evaluate public accounting firm and individual auditor's independence and ability to comply with other relevant ethical requirements with regard to prospective auditee
3. Evaluate competence & resources required	Consider where PA firm has competence and resources to perform audit, including any need for special skills
4. Information about business risks	Obtain info to understand business' risks and get management to accept responsibility for preparing F/S and implementing controls to reduce risks of error and fraud
5. Determine special considerations	Consider if engagement requires special attention or involves unusual risks
6. Information about organization	Search for information about organization, giving particular attention to integrity of principles of management
7. Communicate with prior auditors	<u>For new audits</u> , communicate with previous auditors

Communicating with Predecessor Auditor

- Professional conduct rules **require new auditor to contact old one** and **old auditor must respond** to request

New Auditor asks...	Responsibilities and Requirements
...Old Auditor...	<ul style="list-style-type: none"> About client's integrity, any disputes they had, audit fees, audit procedures Why the client left to begin with Obtain only the necessary info from their old audit files → They belong to the old auditor, not the client
...Client...	<ul style="list-style-type: none"> Ask consent to contact prior auditors; if refused this increases risk

Engagement Letter

Purpose	Discuss the terms of engagement along with including an agreement about fee when a new audit client is accepts to minimize future misunderstandings about the audit
Main Contents	<ol style="list-style-type: none"> Objective and scope of the audit of the F/S Responsibilities of both the auditor and management Which financial reporting framework will be used Reference to the expected form and content of the report to be used by the auditor
Other Contents	Arrangements regarding planning and performance of audit, including... <ul style="list-style-type: none"> Composition of audit team Agreement from auditee to provide auditor with any information in a timely manner Description of the fees and any billing arrangements

Understanding Client Business, Environment and Risks – CAS 315

Roles & Responsibilities	Scope of Roles, Responsibilities and Procedures
<i>Obtaining Understanding</i>	<ol style="list-style-type: none"> <i>External Aspects:</i> Industry, regulation, economic environment, reporting specifications <i>Nature of Entity:</i> Operations, ownership, governance, structure, investments, financing <i>Accounting Policies and Information System</i> <i>Entity's Objectives and Strategies</i> <i>Entity's Main Performance Measures</i>
<i>Identification and Assessment of Risks of Material Misstatement</i>	<i>Financial statement level; Assertion level for classes of transactions, account balances & disclosures (CoT, AB&D)</i> For this purpose, auditor will... <ul style="list-style-type: none"> Identify risks throughout process of obtaining understanding of entity and its environments Assess identified risks and evaluate if relate more pervasively to F/S as a whole Relate identified risks to what can go wrong at assertion level, accounting for relevant controls tested Consider likelihood of misstatements and if they could result in material misstatement
<i>Risk Consideration</i>	<ul style="list-style-type: none"> If risk is risk of fraud If risk is related to recent significant economic, accounting or other developments If risk involves significant transactions with related parties or that are outside normal course of business Complexity of transaction Degree of subjectivity in measurement of financial information related to risk

Preliminary Analytical Procedures – CAS 315

Procedures	Description of Procedures
<i>Inquiries</i>	Inquiries of management and others within entity, believe to have information to identify misstatement risks
<i>Observation & Inspection</i>	Observation and inspection of procedures and controls of entity
<i>Analytical Procedures</i>	<ul style="list-style-type: none"> Horizontal analysis Vertical analysis Review accounting misstatements from previous years Talk to auditee personnel Review corporate charter and bylaws/partnership agreement Review contracts, agreements, and legal proceedings Reading and study of minutes of meetings of BoD, governance of organization, and subsidiaries of board

Materiality

Levels of Materiality	Measurement	Description & Considerations
Overall Materiality	<ul style="list-style-type: none"> • 5 – 10% IBIT • 0.5 – 5% Gross Profit • 0.5 – 1% Total Assets • 0.5 – 5% Shareholder's Equity • 0.5 – 2% Sales 	<ul style="list-style-type: none"> • Preliminary judgement of materiality set prior to conduct detailed audit tests • Involves quantitative & qualitative professional judgement, which depends on auditor's perception of what matters for F/S users • Account for cumulative effects of errors and special circumstances <p><u>Intentional misstatements are always considered material, regardless of size</u></p> <p>Consider if they...</p> <ul style="list-style-type: none"> • Mask change in earnings • Hide failure to meet analysts' consensus • Concern significant segment of business • Affect client's compliance with regulatory requirements (e.g. debt covenants) • Have effect of increasing management compensation
Materiality for CoT, AB&D	Based on specific case	<p><i>Smaller levels can be required when lesser amounts could influence economic decisions of users for particular CoT, AB&D; Includes...</i></p> <ul style="list-style-type: none"> • Law, regulation or applicable financial reporting framework regarding measurement of items • Key F/S disclosures required in relation to industry • Particular aspect of entity's business to be disclosed separately
Performance Materiality	50 – 80% of OM	<ul style="list-style-type: none"> • Aggregated individual immaterial misstatements may cause F/S to be materially misstated • Auditors determine PM level to reduce probability that undetected/uncorrected misstatements exceed materiality of F/S as a whole • Difference between PM and OM is a cushion
Non-Significant Errors	Around 1% of OM	<p>If misstatement found...</p> <ul style="list-style-type: none"> • Above PM → Ask client to record adjustment immediately • Below Non-significant errors → Ignore • In-Between → Document & track it and conclude on aggregate materiality

Management Assertions

- **Management** make **assertions** about **transactions** throughout year and **account balances & disclosures** at year end
- **Auditors** must **obtain sufficient** and **appropriate evidence to verify** all management assertions

Assertion	Justification for Verifying	Transactions	Y/E Balances	Disclosures
<i>Existence (E)</i>	<ul style="list-style-type: none"> • Asset, obligations and equities exist • Transactions actually occurred 	Transaction Occurred	Items Exists	Disclosures correspond to real events
<i>Ownership (O)</i>	Assets, obligations and equities recorded belong to company	Transactions pertain to entity	Controls or has rights to items	Disclosed events pertain to entity
<i>Completeness (C)</i>	All transactions and accounts are included	All transactions are recorded	All items included in F/S	All necessary disclosures are included
<i>Cut-Off (Co)</i>	<ul style="list-style-type: none"> • The amounts are recorded in correct period • Link with (E) and (C) 	Transactions recorded at right dates	Items recorded in proper period	
<i>Valuation (V)</i>	Measurement of amounts recorded is correct	Recorded amounts accurately measured	Proper valuations of items	Disclosed information is accurate
<i>Presentation (P)</i>	<ul style="list-style-type: none"> • Amounts recorded are in proper accounts • Adequate disclosures are provided in notes 	Transactions are classified in proper accounts	Presentation of F/S is correct	Disclosures are understandable

CHAPTER 6 – ASSESSING RISKS AND INTERNAL CONTROL

Audit Risk Model

Component	Description	Key Factors
<i>Audit Risk (AR)</i>	<p><u>Beta Risk</u> Probability that audit will provide an unqualified opinion when material misstatement exists</p> <ul style="list-style-type: none"> • Acceptable AR will always be low (1-5%) • Audit Assurance = 1 - AR 	<ol style="list-style-type: none"> 1. External users' reliance on F/S 2. Likelihood of financial difficulties 3. Management integrity 4. New Client
<i>Inherent Risk (IR)</i>	<p>Likelihood of material misstatement in F/S, assuming no internal controls exists</p> <p>Auditors do not create or control this type of risk; they simply use their judgement to assess its magnitude based on...</p> <ul style="list-style-type: none"> • Prior experience • Nature on transactions • Characteristics of client's business • Effectiveness of client accounting team and accounting system 	<ol style="list-style-type: none"> 1. Previous Audit Results 2. Economic conditions 3. Initial engagement (new client) 4. Competency & experience of accounting staff 5. Doubts about management integrity 6. Nature of business 7. Changes in technologies and organization changes 8. Actual or suspected fraud affecting entity 9. Non-routine transactions 10. Complexity of accounting policies & level of judgement required 11. Related party transactions 12. Assets susceptible of theft 13. Management incentives to manipulate earnings
<i>Control Risk (CR)</i>	<p>Risk that client's internal controls will not prevent or detect a material misstatement</p> <p>OR</p> <p>Likelihood that misstatements will not be detected or prevented by internal control systems</p>	<ol style="list-style-type: none"> 1. Quality of corporate governance processes 2. Effectiveness of internal control procedures
<i>Detection Risk (DR)</i>	<p>Risk that auditor's procedures will fail to find material misstatement that exists in accounts</p> <p>OR</p> <p>Risk that audit procedures fail to detect material misstatements</p>	<ul style="list-style-type: none"> • To reduce DR, more audit evidence is required • Only risk which is controllable by auditor, through extent of audit testing

Risk of Material Misstatement (RMM)

- **RMM = IR * CR**
- Sometimes difficult to separate IR and CR, thus **auditors** may **make combined assessment** of IR and CR

Considerations about the Audit Risk Model

- Usually assess **risk levels** at **LOW; MODERATE; HIGH**
- Used to **identify** and assess each **potential risk** and **document conclusions** about them

Client Business Risk

- **Risk** that **client** will **fail** to **achieve** its business **objectives** and **execute** its **strategies**
- **Crucial** in determining **acceptable** level of **AR** and **RMM**

What Auditor Needs to Understand	Where to Focus Understanding On
<i>Industry and external environment</i>	<ul style="list-style-type: none"> • Unique accounting environments of given industries • Economic conditions & extent of competition • Regulatory environment
<i>Business operations and processes</i>	<ul style="list-style-type: none"> • Major sources of revenue & financing • Key customers & suppliers • Identify related parties • Understand reporting structure and information systems
<i>Management and governance</i>	Assess management's philosophy and operating style and its ability to identify and respond to risk
<i>Objectives and strategies</i>	<ul style="list-style-type: none"> • Reliability of financial reporting • Effectiveness and efficiency of operations • Compliance with laws and regulations • Going concern
<i>Measurement and performance</i>	Identify key performance indicators used within the firm

Relationship Between Materiality and Audit Risk

Audit Risk	Materiality
<ul style="list-style-type: none"> Refers to likelihood of undiscovered misstatements Sets desired level of assurance that material misstatements do not exist 	Refers to magnitude of misstatement
Both deal with sufficiency of evidence and extent of audit evidence that will be collected	
<i>Auditor makes assessments independently, using...</i>	
<ul style="list-style-type: none"> Professional judgement Knowledge of client's F/S users Knowledge of industry Results from previous audits 	

CHAPTER 8 – AUDIT EVIDENCE AND ASSURANCE

Audit Evidence

About	Justification & Description
<i>What</i>	Information used by auditor to determine if F/S are fairly stated
<i>When</i>	Gathered throughout audit process (during risk assessment and when substantive tests & tests of controls take place)
<i>Why</i>	Used to Identify RMM by... <ul style="list-style-type: none"> Assertion Major classes of transactions and material account balances
<i>Audit must decide on...</i>	<ul style="list-style-type: none"> Type of audit evidence being collected Which items to select (population or sample) Timing of when evidence will be collected → Audit Program: <i>detailed instructions to collect evidence</i>

7 Types of Audit Evidence

Evidence	Description	Relation to Management Assertions
1. <i>Recalculation</i>	Check mathematical accuracy	Valuation → Ensure calculated correctly
2. <i>Re-performance</i>	Auditor's independent re-execution of procedures originally performed by entity's internal controls	<u>No assertions</u> Ensures controls and procedures work; does not affect accounting numbers
3. <i>Observation</i>	Observe how activities are performed; how internal controls are applied	<u>No assertions</u> Observing people performing their tasks; related to controls
4. <i>Confirmation</i>	Ask written/oral responses from independent 3 rd parties	<ul style="list-style-type: none"> Existence → Confirm its existence Completeness & Presentation → Confirm no info missing/misrep'ed Valuation & Cut-Off → Use records to recalculate & measure time Ownership → Using 3rd party sources to determine possession
5. <i>Enquiry</i>	Ask explanations to client to obtain information from knowledgeable persons	Tests all assertions, however cannot stand on its own
6. <i>Inspection</i>	<i>Assets</i> Physical examination of assets	<ul style="list-style-type: none"> Existence → If can be looked at, it must exist Valuation → Can be possible to determine if write down needed
	<i>Documents</i> Examination of documents and records <ul style="list-style-type: none"> Vouching → Acco records to Back up Tracing → Back up to acco records 	<ul style="list-style-type: none"> Existence → Relates to <u>Vouching</u> Completeness → Relates to <u>Tracing</u> Cut-Off → Using documents to determine period cut-off Ownership → Using documents to ensure possession Presentation → Determining if items in proper account
7. <i>Analytical Procedures</i>	<ul style="list-style-type: none"> Comparison of numbers with benchmark Analyze relationship between recorded amounts to identify fluctuations/inconsistencies 	Tests reasonableness, but normally an analytic results in another type of evidence

Persuasiveness of Audit Evidence

➤ Objective of auditor is to collect sufficient appropriate audit evidence to support audit opinion

Characteristics of Evidence		Description
Sufficiency (quantity)	Was enough evidence collected	
Appropriateness (quality)	Relevance	Does this pertain to the audit objective
	Reliability	<ol style="list-style-type: none"> 1. Auditor's direct knowledge 2. Independent external sources 3. Effectiveness of internal controls 4. Qualification of provider 5. Objectivity (verifiable facts) or subjectivity (opinion, estimates) of evidence 6. Consistent multiple sources
	Other Considerations	<ul style="list-style-type: none"> • External documents directly obtained by auditor • Written evidence > Oral evidence • Original document > Copies

Audit Documentation

Purpose	Must be sufficient to allow experienced auditor (with no prior connections with audit engagement) to understand: <ol style="list-style-type: none"> 1. Nature, timing & extent of audit procedures performed 2. Results of audit procedures and audit evidence obtained 3. Significant matters arising during audit 4. Conclusions reached 5. Significant professional judgements made 	
Working Papers	Written/electronic audit documentation summarizing work done, analysis performed and supports conclusion, by... <ul style="list-style-type: none"> • Existence or absence of misstatements • Conclusions about significance (misstatements) • Potential follow-up procedures to be performed 	
Audit Software Benefits	<ul style="list-style-type: none"> • Increase productivity by automating tasks • Integration with client databases • Links between audit program and working papers 	
Examples of Audit Documentation	<ul style="list-style-type: none"> • Analysis • Audit Programs • Checklists • Conclusion Reached • Correspondence concerning significant matters 	<ul style="list-style-type: none"> • Letters of confirmation and letters of representation • Memos • Significant matters arising during audit • Significant professional judgement made • Summaries of significant matters

Standards for Preparing Working Papers

Standard	Additional Information
1. Properly Identified	Papers are identified appropriately
2. Well Organized	Papers are organized in an orderly fashion
3. Clearly indicate work performed	<ul style="list-style-type: none"> • Show assertions that were audited • Explain evidence gathered about them • Evaluation of materiality of misstatements found • Conclusion clearly stated
4. Show evidence that work was planned and supervised	Have supervisors sign off on work and be present at each step of the audit
5. Show professional skepticism was used	E.g. Procedures performed to corroborate managements responses to auditors inquiries
6. Show significant matters were reported to auditee	<ul style="list-style-type: none"> • Matters that give rise to significant risks • Results of audit procedures indicating that F/S could be materially misstated • Circumstances that cause auditor significant difficulty in applying necessary audit procedures • Findings which could result in a modification to the audit opinion
7. Working papers indexing	<ul style="list-style-type: none"> • Index • Cross-referencing • Heading (include name of entity, period being audited, and title of audit test) • Initials (of preparer and reviewer) • Dates (of preparation and review) • Tick marks (to indicate work is done)

Permanent vs Current Files

Permanent Files	Current Files	
<i>Contains documents of historical or continuing nature Information to be used year after year</i>	<i>Contains working papers related to current year audit</i>	
<ul style="list-style-type: none">• Copies from corporate charter• Contracts and other agreements• History of company, description of products, markets, etc.• Minutes from shareholders' and directors' meetings• Continuing schedules for share capital, RE, capital assets	<u>Audit Administrative Papers</u> <ul style="list-style-type: none">• Engagement letter• Staff assignments• Meeting notes• Engagement planning memo• Internal control questionnaire• Overall audit strategy• Audit program• Working trial balance	<u>Audit Evidence Papers</u> <ul style="list-style-type: none">• Audit working papers• Adjusting entries• Reclassification entries• Review notes