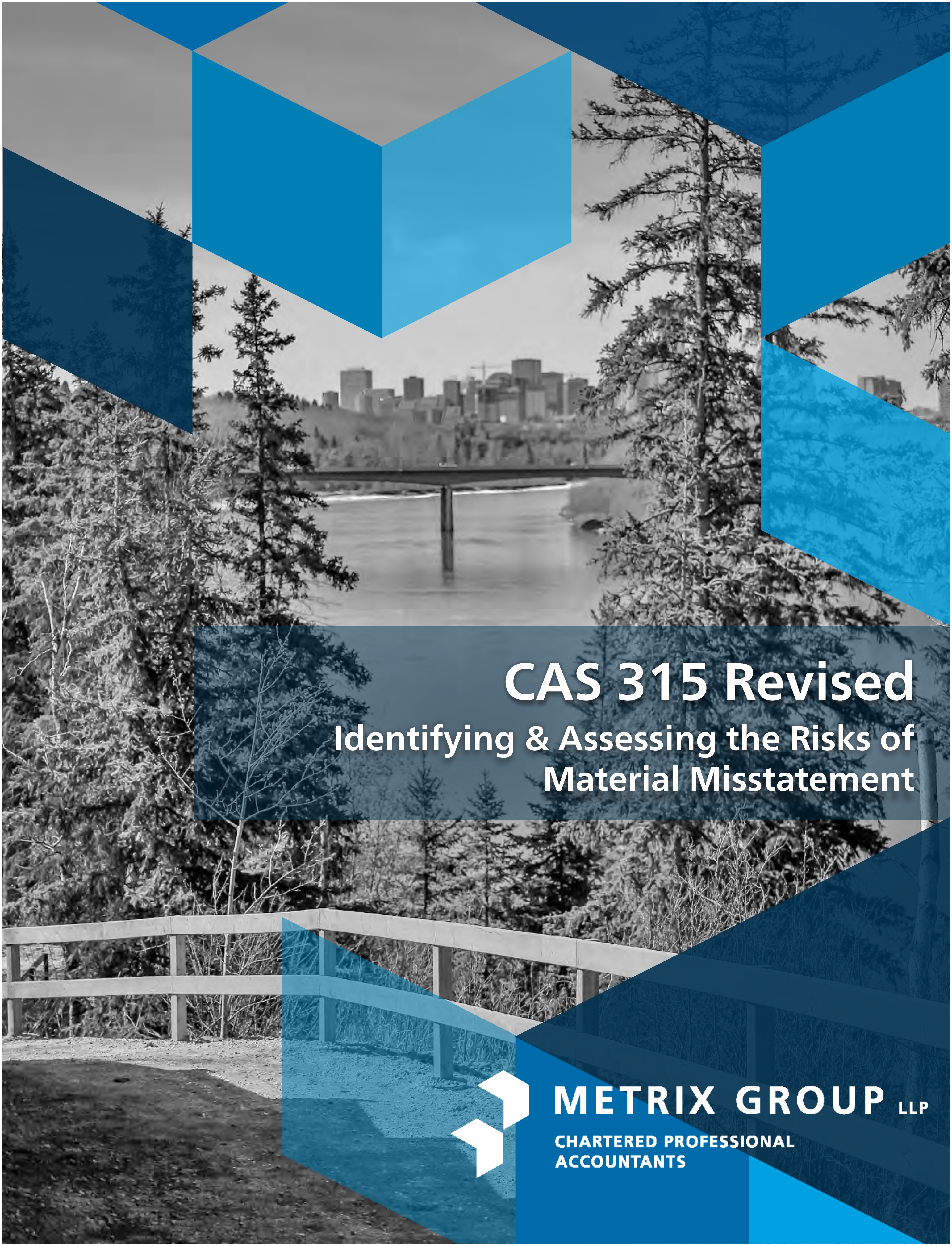

CAS 315 Revised

Identifying & Assessing the Risks of Material Misstatement

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What is the CAS 315 Revised?

Canadian auditing standard 315 (CAS315) deals with the auditors' responsibility to identify and assess the risk of material misstatements in the financial statements. Effective for the audit of financial statements for periods beginning on or after December 15, 2021, CAS 315 has been enhanced in response to the ever evolving economic, technological, and regulator environments in which entities operate. The changes have been implemented to create a consistent and robust risk assessment process. While there are new requirements under CAS 315 that have been significantly revised, the risk model and objectives of CAS 315 remain unchanged.

Key changes and the audit impact?

Understanding Control Activities

Previously, auditors were required to identify “controls relevant to the audit”. This terminology resulted in an inconsistent application of controls being tested by different auditors. CAS 315 revised now identifies five types of controls that address risks of material misstatement at the assertion levels.

They include:

1. Controls that address a significant risk (as determined by the auditor).
2. Controls over journal entries, including non-standard journal entries used to record non-recurring unusual transactions or adjustments.
3. Controls for where a test of operating effectiveness is planned.
4. Other controls that, based on the auditor's professional judgment, are considered to be appropriate to obtaining audit evidence.
5. General information technology controls (“GITCs”) that address risk arising from the entity's use of information technology (“IT”).

The inclusion of assessing GITCs is likely to present an increase in additional work compared to prior years. As part of our risk assessment process, we are required to identify related risks arising from the use of IT AND the entity's GITCs that address those risks. Factors that may increase the amount of work performed over GITCs include:

- Number of IT applications utilized in the preparation of the financial statements;
- Complexity of software utilized;
- The type of system-generated reports utilized; and
- Control deficiencies identified.

This enhanced definition of controls relevant to the audit is likely to result in additional inquiries and procedures performed over:

- Established systems (e.g., how various reports from different software are utilized and interact);
- Processes (e.g., additional inquiries for more detailed narratives about how transactions are initiated, recorded, processed, and reported); and
- Internal controls, specifically with a greater emphasis on risks arising from the use of IT ("RAFUIT") and GITCs. (e.g., how are system generated reports reviewed for accuracy and completeness, processes to manage access, processes to manage changes to the IT environment, data backup and recovery, …etc)

This new approach informs our risk assessment process in determining appropriate responses to each risk identified. Where new significant risks are identified, additional procedures will be required in response.

Inherent risk factors and the Spectrum of inherent risk

Understanding an entity's inherent risks is critical to the risk assessment process. CAS 315 revised introduces the concepts of inherent risk factors, and the spectrum of inherent risk.

Inherent risk is the susceptibility of the financial statements to a material misstatement prior to considering internal controls. As part of an audit, we are required to understand how inherent risk factors affect susceptibility of assertions to misstatements to find where the possible risk of material misstatements are. Historically, inherent risk was assessed at the assertion level over classes of transactions, account balances, and disclosures with responses designed for each inherent risk identified. Under CAS 315 revised, the risk assessment process focuses on significant classes of transactions, account balances, and disclosures ("SCOTABD"). The identification of SCOTABDs will require the identification of significant inherent risks which are identified on a spectrum of inherent risk.

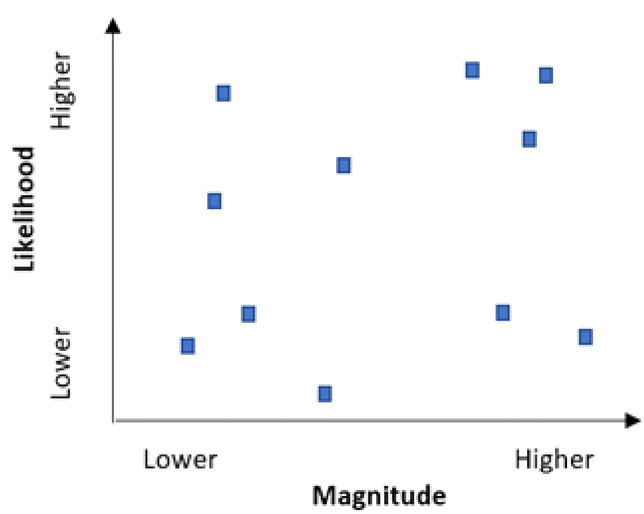
The spectrum of inherent risk is a new concept in CAS 315 revised. The judgment about where in the range inherent risk is assessed will vary based on the nature, size, and complexity of the entity, and takes into account the assessed **likelihood** and **magnitude** of the misstatement and inherent risk factors.

Likelihood of a misstatement is based on the consideration of the inherent risk factors.

Magnitude of a misstatement is based on qualitative and quantitative aspects of the possible misstatement.

Significant risks are assessed based on the auditor's professional judgment and will be mapped appropriately on the spectrum.

CAS 315 revised provides further explanation about inherent risks through the consideration of inherent risk factors. Inherent risk factors are characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure before consideration of controls.



Each square represents a different inherent risk assessment for an identified risk of material misstatement.

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Inherent Risk Factors Include:

Complexity

Arises from the nature of information or how the required information is prepared.

Subjectivity

Arises from inherent limitation in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take.

Change

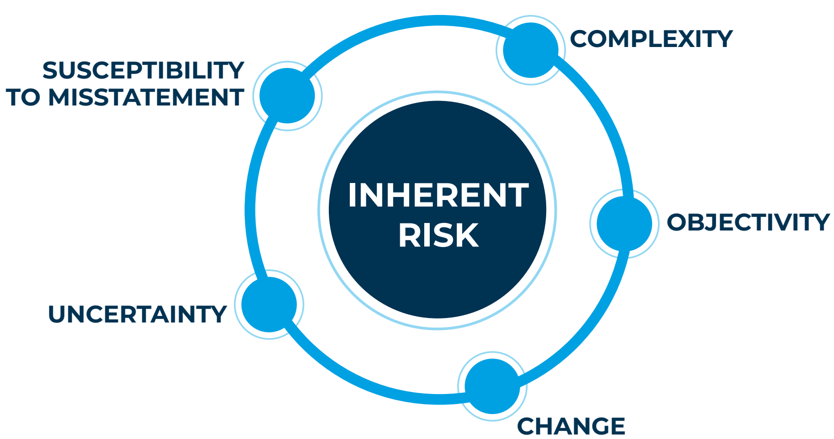
Results from events or conditions that, over time, affect the entity's business or the economic, accounting, regulator, industry or other aspects of the environment which it operates, when the effects of those events or conditions are reflected in the required information.

Uncertainty

Arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the most appropriate available data, when it is not.

Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

Susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment, which result in a material misstatement of the information that would be fraudulent if intentional.



The change to how inherent risk is assessed is designed to provide the auditor with more focus and quality in the risk assessment process. This enhanced review of inherent risk will be more granular and complete. It will require an enhanced understanding of the entity and may result in the identification of new risks assessments

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Stand-back analysis and Professional skepticism

As previously noted, our risk assessment is performed at the beginning of the audit. However, the risk assessment process is an iterative process, and this is no more evident than in the requirement of the "stand-back" analysis. The last major change introduced in CAS 315 revised is the concept of a "stand-back" analysis, which requires the us to perform other supplemental procedures to evaluate if the initial risk assessment remains appropriate throughout the audit where there is a material balance with no associated risk identified. This may result in changes in materiality, the identification of new SCOTABDs during the audit, or additional inquiries and procedures performed throughout the audit.

As your auditor, we are required to constantly exercise professional skepticism. This professional skepticism in relation to the risk assessment process may result in additional inquiries including:

- Questioning contradictory information and the reliability of documents;
- Considering responses to inquiries and other information obtained from management and those charged with governance;
- Being alert to conditions that may indicate possible misstatement due to fraud or error; and
- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances.

What does this all mean?

The additions and enhancements introduced in CAS 315 revised will result in a more robust risk assessment process. This will however result in additional inquiries and procedures to be performed relative to prior year audits, even for existing clients. In preparation for the audit, below are examples of additional requests that you may receive in the coming audit:

- Additional inquiries as part of the inherent risk assessments, include a better understand the entity's business model.
- More information requested about the entity's own risk assessment process.
- More detailed process and control narratives, including how transactions are initiated, recorded, processed, and recorded; and how internal controls are monitored.
- Requests for details on additional policies and procedures.
- Request for a greater involvement of your IT department in the audit including assistance in understanding:
    - IT applications, the IT infrastructure, and how it functions in the entity's business model.
    - Understanding of IT processes.
    - Understanding of the IT personnel involved in the IT process.

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