

## **An overview of the audit process**

Our general approach to an audit is to assess the risks of material misstatement in the financial statements and then respond to those risks by designing audit procedures.

Our risk-based approach focuses on obtaining sufficient appropriate audit evidence to reduce the risk of material misstatement in the financial statements to an appropriately low level. This means that we focus our audit work on higher risk areas that have a greater risk of being materially misstated. Independent auditors must now obtain an understanding of the entity and the environment in which it operates including, but not limited to:

- a) Understanding the governance structure and its effectiveness.
- b) Composition of the Board of directors (financial expertise represented on the Board ) and frequency of meetings.
- c) The entity's risk management process – what is the process to assess and monitor the risks facing the entity and is it documented (see below for the benefits).
- d) Information Technology (“IT”) – how does this impact the entity; access to confidential information; controls in place over outside consultants e.g. bookkeeping.
- e) How secure is the entity's web-site? Who monitors? How secure is membership information collected? Who advises/consults in IT?
- f) Understanding the roles of the various Committees and their mandate.
- g) How is the risk of fraud or other illegal acts being addressed? Management is now required to provide us with information relating to fraud or suspected fraud affecting the entity - internal or external. Auditors are required to assess this risk.

The benefits of a formal risk management process include:

- 1) Improving the entity's management practices and helping the entity achieve its business goals; and
- 2) Assisting their external auditors by identifying the risks of material misstatement in financial statements and providing the needed documentation to evaluate the entity's risk assessment process. It may also enable more cost-effective audit procedures to be performed.

An efficient and timely audit of depends on how well management has discharged these responsibilities. Many not-for-profits do not formally document their objectives and strategies and as well does not have a formal process to assess risk or

monitor. As a result, auditors have to perform additional work at added cost to understand the financial statements, what the entity's accounting policies should be in accordance with generally accepted accounting principles (as opposed to what are approved by the Board), consider relevant disclosures and also the appropriateness of the Information returns prepared for filing with the Canada Revenue Agency.

### **Controls over Financial Reporting**

Management's responsibilities over Financial Reporting include designing and implementing an adequate system of internal control over its financial reporting process (and monitoring) to ensure that its financial reports are reliable and complies with Canadian generally accepted accounting principles. This includes whether the organization can properly implement the changes with respect to the new financial instrument standards issued recently by the Canadian Institute of Chartered Accountants.

Auditors have to assess the adequacy of the design of the internal controls as a necessary part of the audit planning process and report to management any significant weaknesses that could result in material misstatements in the financial statements.

### **Financial Instruments**

The new financial instruments standards are very pervasive and have a direct impact on financial reporting. This will have to be considered and a summary of the basic requirements of the new standard is discussed below.

### **Audit fees and timing**

We recommend that a meeting be convened as early as possible with the auditors to discuss the above and what management and the Board needs to do to move up to an audit. At this meeting we can also discuss the various responsibilities, timing and fee estimates. We suggest that this meeting be held as soon as possible as the year end is almost here.

### **Summary of CICA Hand Book Section 3855 – Financial Instruments**

The new financial instruments section recognizes that fair value is the most relevant measure for financial instruments and the only relevant measure for derivative financial instruments. This summary does not deal with presentation and disclosures.

Financial instruments are required to be classified as follows i.e. what is management's intention with respect to these instruments:

**Available for sale instruments** – Record at FAIR value (except those equity instruments that do not have a quoted market price then record at cost). Gains and losses are recognized in income for the period but classified separately from other gains and losses. Note that financial assets are re-measured to fair value at each year end.

**Held for trading** – Recognize at fair value. Gains and losses recognized immediately as net income

**Held to maturity instruments** – Recognize at fair value. Fair value is the amortized cost using the effective interest method. All gains and losses recognized immediately as income when the asset is derecognized. Impairment write-downs and foreign exchange translation adjustments recognized immediately in net income.

**Loans and receivables** – Recognize at fair value i.e. amortized cost or effective interest method.

A **financial asset held for trading** is primarily for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Note that an entity can also designate any financial instrument irrevocably on initial recognition as held for trading regardless if it intends to sell or repurchase in the near term.

**Available for sale financial assets** are those non-derivative financial assets that are

- designated as available for sale, or
- that are not classified as loans and receivables, held -to-maturity investments or
- held for trading.

**A financial asset held to maturity**

An entity does not have a positive intention to hold to maturity a financial asset with a fixed maturity when any one of the following conditions is met:

- (a) the entity intends to hold the financial asset for an undefined period;
- (b) the entity stands ready to sell the financial asset (other than when a situation arises that is non-recurring and could not have been reasonably anticipated by the entity) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of, and the yield on, alternative investments, changes in financing sources and terms, or changes in foreign currency risk; or
- (c) the issuer has a right to settle the financial asset at an amount significantly below its amortized cost.

**A derivative** is a financial instrument or other contract with all three of the following characteristics:

- (i) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or other variable (sometimes called the "underlying"), provided in the case of a non-financial variable that the variable is not specific to a party to the contract;
- (ii) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- (iii) it is settled at a future date.