## Mission Statement

*The Hamilton Public Library unites people and ideas in a warm and welcoming environment. The library's staff, collections, and access to global electronic resources help to enrich the lives of individuals. The library actively champions literacy, access to information, and the joy of reading.*

## Strategic Priorities

*Strengthen Communities*
*Support Diverse Needs*
*Continue to develop and energize our organization*

# HAMILTON PUBLIC LIBRARY BOARD

## Audit Committee

**Monday, January 30, 2006**
**Central Library, Board Room**

**4:30 p.m.**

**AGENDA**

1. Acceptance of the Agenda
2. Appointment of Chair of the Audit Committee – Terms of Reference — Attachment #2
3. Presentation by the External Auditors Grant Thornton –
   Hamilton Public Library Board 2005 External Audit Plan Communication
4. 2005 External Audit Plan and Fees — Attachment #4
5. Date of next meeting
6. Adjournment

Attachment #2

# AUDIT COMMITTEE

**Terms of Reference**

## PURPOSE

The Committee is to oversee the financial reporting process, monitoring the choice of accounting policies and procedures and monitoring internal control procedures to ensure the effective development and maintenance of adequate financial controls and reporting. The Committee is to be independent of the auditing function and ensure appropriate actions are taken with audit findings. The Committee has no direct responsibility for the operations and functions of audit areas. It does however make recommendations to the Board regarding both factors.

## Appointment of External Auditors

Under the authority of the Municipal Act, the City of Hamilton shall appoint the external auditor for the Hamilton Public Library.

## Membership

The Audit Committee will be composed of three members of the Hamilton Public Library Board. A quorum shall be two members.

Preference will be given to Library Board members who are financially literate with relevant background in financial matters (i.e. prior experience as a business person, recognized accounting designation, work in the accounting profession, or in the financial accounting department of a current or past organization). Committee members will have no current business relationship or financial interests with the Library or its management.

Members will be appointed at the first meeting in the first year of the Board's term and will serve until the end of the Board's three (3) year term of office.

The members of the Audit Committee will appoint one of the members as Chair who will chair the meeting of the Audit Committee and perform such other duties as required to ensure the proper functioning of the Committee.

## Meetings

The Committee will meet at least twice in each year – in the fall with the external auditors to discuss the scope of the annual audit and in the spring with the external auditors to discuss the results of the annual audit.

Additional meetings may be held at the Call of the Chair of the Audit Committee, request by a Committee member or by the external auditors.

Notice of each meeting confirming the venue, time and date of the meeting together with an agenda of items to be discussed shall be forwarded to each member of the Committee prior to the date of the meeting in a timely manner.

The external auditors, Chief Librarian and the Director, Finance and Facilities will be invited to attend meetings and at least once a year, the Committee will meet with the external auditors without Library staff present.

The Audit Committee may invite such other persons to its meetings as it deems necessary.

## Duties

The duties of the Committee will be:

To meet with the external auditors before the audit commences and to discuss and approve the nature and scope of the audit

To discuss with external auditors issues such as compliance with accounting standards and proposals by external auditors

To monitor the integrity of the financial statements of the Library and to review, and challenge where necessary, the actions and judgements of management in relation to financial statements before submission to the Board, focusing particularly on:

- Significant accounting policies and practices and any changes in them;
- Major judgemental areas
- The extent to which the financial statements are affected by any unusual transactions in the year and how they are disclosed;
- The clarity of disclosures
- Significant adjustments resulting from the audit

To meet with the external auditors post-audit at the reporting stage to discuss the audit, including problems and reservations arising from the audit, and any matters the auditor may wish to discuss;

To review the management representation letter, the external auditors' management letter and the management's response.

To monitor and review the internal audit programme (if any) and its effectiveness;

To monitor and review the Library's systems for internal financial control, financial reporting and risk management;

To consider any major audit recommendations and to consider the major findings of internal investigations and management's response;

## Reporting

The minutes of the meetings of the Committee shall be circulated to all members of the Committee and to all other members of the Board.

The Chair of the Committee shall report to the Board on all meetings of the Committee.

The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its responsibility where action or improvement is needed.

The Committee members shall conduct an annual review of their work and these terms of reference and make recommendations to the Board.

Attachment #4

# Hamilton Public Library

**Date:** January 23, 2006

**To:** Chair and Members of the Board

**From:** William Guise, Director, Finance and Facilities
Hamilton Public Library

**Subject:** **2005 External Audit Plan and Fees**

---

## RECOMMENDATION:

(a) That Grant Thornton LLP Chartered Accountants be confirmed as External Auditors for the Hamilton Public Library Board.

(b) That the 2005 Audit Fees in the amount of $6,000 plus applicable taxes be approved.

(c) That the Hamilton Public Library Board 2005 External Audit Plan Communication, prepared by Grant Thornton LLP Chartered Accountants be approved.

## FINANCIAL/STAFFING/LEGAL IMPLICATIONS:

## BACKGROUND:

Grant Thornton, Chartered Accountants, audit approach and scope of audit work for the Hamilton Public Library Board for the 2005 fiscal year is provided in the attached 2005 External Audit Plan Communication. The Audit Plan communicates to the oversight body Grant Thornton's overall audit responsibilities and audit approach in accordance with Canadian generally accepted auditing standards. New auditing standards from the Canadian Institute of Chartered Accountants ("CICA") focus the audit on areas where there is greater risk of misstatement. Grant Thornton has tailored their audit of the Library to several specific audit areas.

Grant Thornton has advised the Library that the audit fee for the 2005 fiscal year is estimated at $6,000 up from $5,000 for 2004 fiscal year as a result of additional work required by the new auditing standards from the CICA.

Grant Thornton was appointed the City's external auditor by Council at its meeting on May 15, 2001 for a period of five years. Under Municipal Act, the external auditor for the City is also the auditor for the Library Board.

# Hamilton Public Library Board
# 2005 External Audit Plan Communication

**Submitted to**
**Members of the Board**
**January 2006**

Grant Thornton

# Contents



# Appendices

We are pleased to provide our Audit Plan for the December 31, 2005 audit of the financial statements of the Hamilton Public Library Board (the Library) together with our independence letter. This audit plan forms part of our ongoing communication with the Board in accordance with the requirements of the CICA Handbook, "*Communications with those having oversight responsibility for the financial reporting process*". This document is intended to provide for clarification and understanding of roles in the financial reporting and financial audit process, as well as Grant Thornton's services currently provided to the Library.

In this document we also outline current accounting and reporting issues to be considered for the purpose of reporting on the financial statements.

This communication provides an outline of our approach to the examination of the financial statements of the Library. The primary purpose of documenting our approach is to provide a vehicle for effectively communicating the external audit process to the members of the Hamilton Public Library Board. We view the development of our audit service plan as an important process that provides all parties to the audit process with an opportunity to reassess the audit needs, focus areas, approach and expectations for performance. Our audit strategy has been developed based on our knowledge and experience, as well as discussions with management regarding developments during the current year. This plan will be subject to change as we evaluate additional information and assess the results of our procedures completed during the course of our work.

We welcome input to the audit planning process and comments on the Grant Thornton audit approach.

The personnel assigned to the Library audit are as follows:

| Name | Role | Email |
|---|---|---|
| **Evan McDade** | Lead Audit Partner | emcdade@grantthornton.ca |
| **Thane MacKenzie** | Quality Assurance Review | tmackenzie@grantthornton.ca |
| **Melanie Dugard** | Senior Manager | mdugard@grantthornton.ca |
| **Christopher Lukas** | Senior Accountant | clukas@grantthornton.ca |

We realize the importance of staff continuity in the services we provide. Through continuity, our people gain the knowledge of previously addressed accounting and reporting practices so that efficiencies are achieved and maintained. All of the senior personnel noted above represent continuity from the 2003 and 2004 audits.

**Business Environment**

In the past few years, there have been a number of highly publicized business failures, which have called attention to the role and responsibilities of management, Boards of Directors, Audit Committees and auditors. Corporate governance has evolved into a critical issue for regulators, management and the general public.

The current business environment is characterized by the following:

- ◊ Unprecedented focus on high-quality, transparent financial reporting;
- ◊ Increasingly complex and voluminous financial reporting requirements;
- ◊ Expanding disclosure requirements;
- ◊ Increasingly complex and sophisticated business transactions and structures;
- ◊ High profile irregularities and restatements intensifying interest by regulators and others who rely on the financial statements;
- ◊ Greater competency requirements for those responsible for governance (i.e. Board, Audit Committee).

New standards and guidance have been introduced by law makers, regulators and professional bodies in North America in an attempt to address the increased expectation for clearer financial reporting and responsibilities. In particular, recent releases of new reporting and governance requirements for public companies have placed significant emphasis on the proper oversight of financial reporting. While the most significant and publicized requirements relate to publicly traded companies, the changing business environment is impacting on the expectations of all "publicly accountable" organizations, including municipalities and local boards. These changes are manifesting themselves within the municipal movement by way of heightened stakeholder expectations and scrutiny of governance processes, internal controls and financial reporting.

As a result of the changing environment, Corporate Governance is important to all entities. It is important for governing bodies to understand their responsibilities in these areas.

**Role of the Governing Body**

The Audit Committee has overall responsibility for the oversight of an entity's financial reporting. Where an Audit Committee does not exist, this becomes the Board of Director's responsibility. Accordingly, the role of the Board is central to ensuring the integrity of financial information. The Board is therefore expected to be actively involved in overseeing financial reporting and satisfying themselves that the Library's financial reports are comprehensive, reliable, understandable and responsive to the needs of the readers.

In light of the changing business environment, the Board must consider how to conduct certain activities, as a business and risk management necessity, to ensure they are well prepared as effective watchdogs to appropriately focus on the matters critical to quality financial reporting. The Board should ensure that they understand the operating environment, the basic structure of transactions, their business purpose, and the significant implications. In overseeing financial reporting, it is not only important to rely on the information provided but also to challenge, analyze, interpret and evaluate the information.

The importance of the need for effective Corporate Governance has been heightened in the minds of stakeholders. There is an expectation by stakeholders that individuals, who sit in oversight roles, and particularly in governance roles, will act with sufficient discipline and enact robust processes to execute their duties effectively. Grant Thornton encourages Boards and Audit Committees to develop a framework within which governing bodies can best develop and adopt existing "best practices" to support the independent and objective oversight of the financial reporting process.

### Financial Statement Preparation

The responsibility for financial statement preparation, including the notes thereto, and representation lies with management. This responsibility includes the determination of significant estimates made in the preparation of the statements, as well as effective disclosure of transactions and events.

### Internal Controls and Reporting Process

Being responsible for preparing the financial statements includes responsibilities relating to internal control, such as designing and maintaining accounting records, selecting and applying accounting policies, safeguarding assets and preventing and detecting error and fraud, and ensuring the preparation of the financial statements in accordance with Canadian generally accepted accounting principles.

Management is also responsible for assessing the impact of any misstatements detected during the preparation and audit of the financial statements, individually and in aggregate, on the fair presentation of amounts and disclosures contained in those financial statements and determining if such adjustments should be recorded.

**Responsibility of the External Auditor**

Grant Thornton LLP has been engaged to examine the financial statements of the Hamilton Public Library Board as at and for the year ending December 31, 2005. The role of the external auditor is to audit the information contained in the financial statements, including the notes, in accordance with generally accepted auditing standards, and to report to management and the Board.

Our responsibility is to plan and perform an audit to obtain reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. It is important to understand that an audit is not designed to, and should not be relied upon, to provide absolute assurance that there are no misstatements in the financial statements resulting from fraud, irregularities and errors or illegal acts. Due to the inherent limitations of an audit, there is an unavoidable risk that some misstatements of the financial statements will not be detected, even though the audit is properly planned and performed.

The prevention of fraud, irregularities and errors is dependent upon the maintenance of an adequate system of internal control and is a management responsibility. We consider internal accounting procedures and systems of internal controls to the extent necessary to determine our auditing procedures. Our audit work does not provide assurance on the internal control structure, nor do our procedures necessarily cover all control systems upon which management may be relying.

While our audit is not specifically directed towards providing assurance on the internal control systems, a by-product of our audit is a list of concerns and suggestions for improvement that we feel should be brought to the attention of management and the Board. These items are included in a written management letter. Also, any significant proposed audit adjustments that could, in our judgment, either individually or in the aggregate, have a significant effect on the financial statements, will be reviewed with management and reported to the Board.

**Overall Approach**

Our audit approach will focus on:

- Identifying the business risks that may have a significant impact on the financial statements;
- Obtaining an understanding of the Library processes for managing business risks, and processes and controls in place for developing accounting estimates recorded in the financial statements;
- Obtaining an understanding of the significant classes of transactions (eg. receipts, disbursements) and how the Library entities process them through to inclusion in the financial statements;
- Applying our knowledge of the Library to develop expectations about assertions in the financial statements and comparing reported financial results to our expectations.

The risks referred to are those that impact on financial reporting and are not a comprehensive collection and analysis of the entire risk profile for the Library.

The concepts of materiality and audit risk are implicit in the wording of the standard Auditors' Report. It is intended to communicate, amongst other things, that the amounts included in the financial statements are not necessarily precise and that the audit does not provide absolute assurance that the financial statements are not materially misstated. We will seek *reasonable assurance* that the financial statements, as a whole, are not materially misstated.

**Materiality**

Materiality refers to the magnitude or nature of a misstatement, including an omission, of financial information either individually or in aggregate that, in light of surrounding circumstances, makes it probable that the judgment and/or decision of a reasonable person relying on the information would have been influenced as a result of the misstatement. Grant Thornton uses planning materiality to determine the extent of substantive audit procedures.

Auditing Guideline No. 31, *Applying Materiality and Audit Risk Concepts in Conducting an Audit*, provides guidance to auditors in the setting of materiality. The guideline provides clarification of the factors to be considered in applying materiality and emphasizes the greater use of professional judgment to assess errors versus reliance on quantitative assessments. There is also more guidance on assessing qualitative factors that affect materiality and on assessing the effect of misstatements on financial statements. These changes arose in large part due to concerns over "earnings management" by entities. There is now less tolerance for unadjusted identified misstatements, regardless of amount.

For 2005, our planning materiality has been assessed at $210,000.

It is important to note that this is a guidance amount used for sampling purposes only. It is not indicative of the magnitude of the transaction sizes evaluated or the thresholds used, along with qualitative factors, for error evaluation purposes. We will use a lower working materiality in considering whether any misstatements detected during the audit, either individually or in the aggregate, are significant. In our year-end report to the Board, we will also summarize all non-trivial errors that come to our attention, including those that are subsequently adjusted by management.

Management is responsible for maintaining accurate books and records, and the expectation is that all non-trivial errors will generally be corrected. In the current business environment, stakeholders are increasingly sensitive to non-material errors in the financial statements, and in some circumstances, such items may be considered fraudulent financial reporting. As an example, the *US Securities and Exchange Commission's Staff Accounting Bulletin (SAB) 99, Materiality*, advances the view that intentional misstatements, although determined to be immaterial to the financial statements taken as a whole, can be a violation of US securities laws. While the context of the material is the US equity market, i.e. publicly listed companies, it is reflective of internationally evolving expectations of all parties with responsibility for financial reporting, particularly with respect to significant publicly accountable entities.

**Audit Risk**

Audit risk is defined as "the risk that the auditor will fail to express a reservation in his or her opinion on financial statements that are materially misstated". Audit risk includes the following components:

(a) Inherent risk, which is the risk of a material misstatement occurring in the first place;

(b) Control risk, which is the risk that an organization's system of internal control will not prevent or detect a material misstatement;

(c) Detection risk, which is the risk that a material misstatement that has not been corrected by an organization's system of internal control will not be detected by us.

Inherent risk and control risk exist independently of the audit, and are functions of an entity and it's economic and control environments, regardless of whether an audit is conducted. Detection risk relates to the nature, extent and timing of our audit procedures. We will assess inherent and control risks to enable us to design sufficient substantive procedures to reduce risk to a level that, in our judgment, results in an appropriate level of audit risk. There remains a risk that errors will not be found due to inherent limitations of auditing procedures (eg. sampling) and the fact that all relevant information may not be made available to us.

**New Audit Requirements**

Audit requirements and professional standards are continuously changing. Grant Thornton must stay attuned to these changes and ensure that we are in compliance with the professional standards under which we report (i.e. Canadian Generally Accepted Auditing Standards). These standards are not optional. Grant Thornton takes seriously its role in working with the rest of the profession to contribute toward recent standards and pronouncements, and continues to be active in the development and consultation process.

As a result of the changed business environment, there are increased expectations of both auditors and governing bodies to challenge the financial information presented by management. Grant Thornton has implemented further changes to auditing standards which are based on the new International Auditing Standards. These changes require, among other things, a requirement to obtain an enhanced understanding of the entity's business and controls along with a more direct linking of identified risks to specific audit procedures. These changes are significant and are intended to raise the audit standards.

**Assistance from Staff**

A list of working papers to be prepared by Library staff to assist in the audit has been provided to Mr. Bill Guise, by way of a letter November 1, 2005. Audit work associated with financial statement balances will not commence until draft financial statements have been finalized by management.

### Identifying Significant Audit Areas

During the planning process, we identify critical cycles or those transaction cycles that are likely to have the most risk of a material misstatement. Designating a cycle as critical does not necessarily mean that problems are anticipated and areas may be so identified even though no major problems are expected.

Each cycle has a number of assertions, such as completeness and valuation. The same degree of risk of material misstatement does not necessarily apply to all assertions within a critical cycle. Therefore, our judgment as to critical cycles is further refined to the assertion level within a critical cycle. A critical assertion is one where monetary amounts are material, and environmental factors alone (those relating to inherent risk and the control environment), are not sufficient to reduce the risk of material misstatement to an acceptably low level.

The identified areas having a high risk of material misstatement in the Library's accounts include revenues, and operating expenses. As a result, we will perform an increased level of audit work in these areas.

#### Revenues

Revenues represent a critical audit area as a result of the large dollar values and volume of transactions involved. Our approach will include vouching grant revenues to supporting documents as well as an analysis of fine revenue by month. We will audit the reasonability of the accounts receivable at year end by testing subsequent payments and reviewing any accounts written off during the year.

#### Operating Expenses

Operating expenditures represent a critical audit area due to the large dollar value and volume of transactions processed. We will be examining the support for significant expenditures during the year and ensuring appropriate approvals exist. We will also compare operating expenditures to both budgeted and 2004 actual amounts and investigate any significant variations. We will also be testing the payable footing for reasonableness, ensuring that all liabilities at year-end are recorded in the financial statements.

**Library Relationship**

As external auditors of The Hamilton Public Library Board, we are required to be independent in accordance with the Canadian professional requirements. These standards require that we confirm our independence in a written letter, at least annually, and disclose to the Board all relationships that, in our professional judgment, may reasonably be thought to bear on independence. We discuss our relationship with the Library Board in our independence letter provided in appendix A.

We confirm that we are not presently aware of any relationship or non-audit services that would impair our independence for purposes of expressing an opinion on the financial statements.

During our audit, we will communicate any significant new matters at the time the relationship is established or the matter is first identified. At the completion of our audit, we will reconfirm our independence.

**Estimates and Assumptions**

The audit fee reflects our best estimate of the time that will be required to complete the audit, given the nature and size of the Library's operations, the assistance that we have received and expect to receive from financial and non-financial management, our mix of professional staff, the number of critical audit areas, significant financial reporting matters and the condition of the accounting records.

Our fee estimates have been developed based on the assumption that draft financial statements, requested data files and extractions, and year-end working papers are accurately prepared and made available to us in the time frame outlined. Delays in obtaining these items and/or inaccuracies in their preparation and/or reconciliation to related financial documents and reports will adversely impact on our projected fee and will be billed separately. While we have provided a list of required schedules to be prepared by Library staff, we are not able to articulate all that may be necessary due to changing circumstances.

It is management's responsibility to ensure that the books of account, working papers and financial statements are completed and supported by appropriate documentation and where applicable reconciled to third party information.

**Estimated 2005 Fees**

The estimated fee for the 2005 audit for the Library is $6,000. The fee includes all audit related services as itemized in the Audit Approach and Scope of the Engagement section of this document, and all additional audit work in the current year with respect to the proposed changes to accounting and auditing standards, as outlined in Appendix B.

The proposed timing of our 2005 audit efforts is set out below:

| Key Activity | Tentative Timing |
|---|---|
| Audit planning | October 2005 |
| Year-end fieldwork | March $20^{th}$- March $24^{th}$, 2006 |
| Presentation of Draft Financial statements* | May, 2006 |
| Draft management letter | May, 2006 |

The above noted timing is related directly to the timing of the City of Hamilton closing its books for the year. If the City is delayed, the above timing will need to be adjusted accordingly. Timing has been tentatively setup with management as outlined in the schedule above.

The purpose of this Audit Plan Communication is to assist in the Board's awareness and understanding of the audit process and provide information on the roles and responsibility of management, staff and the external auditors.

Upon completion of the audit, matters arising from the audit, including any identified weaknesses in internal control, significant audit adjustments or audit differences, and/or additional advisory comments, will be communicated in writing to the Board. Prior to bringing these items forward, we will review our findings with management and provide them with the opportunity to comment.

Grant Thornton is pleased to continue our provision of external audit services to the Hamilton Public Library Board.

**APPENDIX A**

**INDEPENDENCE LETTER**

October 27, 2005

Members of the Hamilton Public Library Board
55 York Blvd, PO Box 2700
Hamilton, Ontario, L8N 4E4

Dear Board members:

We have been engaged to audit the financial statements of the Hamilton Public Library Board ("Library") for the year ended December 31, 2005.

Canadian generally accepted auditing standards (CICA Handbook section 5751) require that Grant Thornton LLP communicate at least annually with the Board regarding all relationships between the Library and Grant Thornton that, in our professional judgment, may reasonably be thought to bear on our independence.

In determining which relationships to report, the Guideline requires us to consider relevant rules and related interpretations prescribed by the appropriate provincial institute and applicable legislations, covering such matters as:

(a) Holding a financial interest, either directly or indirectly, in a client;
(b) Holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
(c) Personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
(d) Economic dependence on a client; and
(e) Provision of services in addition to the audit engagement.

We are not aware of any relationships between the Library and Grant Thornton that, in our professional judgment, may reasonably be thought to bear on our independence, which have occurred from January 1, 2005 to October 27, 2005.

Grant Thornton

With respect to item (e) we can report that there were no services provided to the Library in addition to the audit engagement.

The auditing standards require that we confirm our independence to the Board of Directors. However, since the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario deal with the concept of independence in terms of objectivity, our confirmation is to be made in that context. Accordingly, we hereby confirm that we are objective with respect to the Library within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of October 27, 2005

We look forward to discussing with you the matters addressed in this letter, as well as other matters that may be of interest to you. We are prepared to answer any questions the Board members may have regarding our independence, as well as other matters.

This report is intended solely for use of the Board and others within Hamilton Public Library Board and should not be used for any other purposes.

Yours truly,

**GRANT THORNTON LLP**

Grant Thornton LLP

Evan McDade, CA, CBV
Partner

# CURRENT ASSURANCE AND FINANCIAL REPORTING DEVELOPMENTS

## Tangible Capital Assets

In June 2005, PSAB approved a drafts of PS 3150, standards on how to account and report Tangible Capital Assets. This section includes definitions given to tangible capital assets held for use, used on a continuing basis, with life beyond one year, and not intended for resale.

The Public Sector Accounting (PSA) Handbook does not currently provide standards for accounting for capital assets for local governments. However, tangible capital assets do have a future economic benefit, and therefore, the stock of tangible capital assets needs to be reported. Local governments do not have a generally accepted definition of what is a tangible capital asset. Items included in tangible capital assets vary from province to province and among local governments within provinces.

Tangible capital assets will include betterments, contributed assets and infrastructure (roads, bridges and water and sewer systems). It will exclude works of art.

Final approval of the exposure draft is now expected by November 2006. It is expected that this section will become effective for fiscal years beginning January 1, 2008.

## Generally Accepted Accounting Principles (GAAP)

PSAB proposes, subject to comments, to issue new Handbook section PS 1150, Generally Accepted Accounting Principles.

The section is intended to clarify GAAP for the public sector. This would include primary sources of GAAP for governments and the criteria that must be satisfied in determining another source of GAAP when a primary source is not available. This section was approved in February 2005 and applies to fiscal years beginning on April 1, 2005.

## Measurement Uncertainty

PSAB approved a new PS Handbook section Measurement Uncertainty, which applies to all levels of government. This section provides a definition of measurement uncertainty and disclosure requirements. The section is effective for fiscal years beginning on or after April 1, 2005.

**Sale-Leaseback Transactions**

PSAB approved PS Guideline PSG-5, Sale-Leaseback Transactions – Expense-Based in June 2005.

The key proposals are as follows:

- To depart from the existing 'interdependence' approach to accounting for sale-leaseback transactions where it is assumed that the terms of the sale and the leaseback are not able to be objectively separated

- To recommend a 'components' approach that assumes the sale transaction can be separated objectively from the leaseback transaction

- To permit only assets and liabilities that meet their definitions in section PS 1000 to be presented on the statement of financial position

- Where the leaseback constitutes a leased tangible capital asset, the transaction is in substance a financing arrangement

- Where the leaseback constitutes an operating lease, it is in substance a sale of the property

Prospective application is required for fiscal years beginning on or after April 1, 2005. Comparative numbers should be restated and reclassified as necessary to conform to the new presentation.

**Financial Statement Presentation**

Prospective application for fiscal years beginning on or after April 1, 2005 (comparative numbers should be re-stated and reclassified as necessary to conform to the new presentation)

This section recommends general reporting principles and standards for the disclosure of information in government financial statements. It includes reporting the change in net debt and reporting the legislative control and financial accountability

## AUDITING DEVELOPMENTS

### Exposure Draft – Audit Risk

The CICA recently issued an exposure draft on assessing audit risk. The proposed standards are based on existing international standards issued by the International Auditing and Assurance Standards Board (IAASB). The proposed standards will harmonize Canadian standards with the IAASB standards. The CICA standards become effective for all audits of financial statements for periods ending on or after December 15, 2005.

The primary objective of the audit risk standards is to enhance how auditors work with and apply the audit risk model. Examples of the enhancements include:

a) A requirement for a more in-depth understanding of the entity and its environment, including the plans and actions resulting from the assessment of business risks and their effect on financial reporting.

b) A requirement to document internal controls over financial reporting for all audits, regardless of the audit approach.

c) A requirement to assess the effectiveness of the design of internal controls against an internal control framework, also regardless of the audit approach. In addition, the standards encourage the auditor to test controls in order to assess their operating effectiveness.

d) A requirement to directly link the assessed audit risks with the nature, timing and extent of audit procedures performed in response to those risks.

e) Expanded documentation requirements.

The goal of these standards is to improve audit quality by providing the auditor with information to enhance the design and performance of audit procedures. The new requirements are intended to provide increased rigor to the auditor's procedures, and to enhance the auditor's knowledge, by requiring the auditor to obtain information not only from people directly involved in financial reporting and management, but also those with operational roles within the entity. The direct link between assessed risks and audit procedures is expected to enhance the focus of the audit on areas where there is a greater risk of misstatement.

### The Auditor's Responsibility to Consider Fraud and Error

In April 2004, the AASB approved revisions to Handbook Section 5135, The Auditor's Responsibility to Consider Fraud and Error. The Section is derived from International Standard on Auditing 240, The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements

(ISA 240), issued by the International Auditing and Assurance Standards Board (IAASB). The new Section applies to audits of financial statements for periods ending on or after December 15, 2004.

The principal changes to Section 5135 include the following:

◊ A requirement for members of the engagement team to discuss the susceptibility of the entity's financial statements to material misstatement due to fraud or error, and a requirement for the engagement partner to consider which matters are to be communicated to members of the engagement team not involved in the discussion;

◊ More specific guidance on enquiries of management and others within the entity on the risk of fraud;

◊ A requirement to design and perform certain mandatory procedures to address the risk of management override of internal controls, including examining journal entries, reviewing accounting estimates for bias and evaluating the business rationale for significant unusual transactions;

◊ A presumption that there is ordinarily a risk of fraud in revenue recognition, a requirement to perform further procedures if the risk is present and a requirement to document the reasons when the auditor has not identified revenue recognition as a risk;

◊ A requirement to incorporate an element of unpredictability in the selection of the nature, extent and timing of the audit procedures performed in response to assessed risks of material misstatement due to fraud;

◊ Significantly more detailed documentation requirements;

◊ Removal of the assumption of management's good faith.