

GUIDE to

*New Canadian Independence Standard*



Chartered Accountants  
of Canada   Comptables  
agréés  
du Canada

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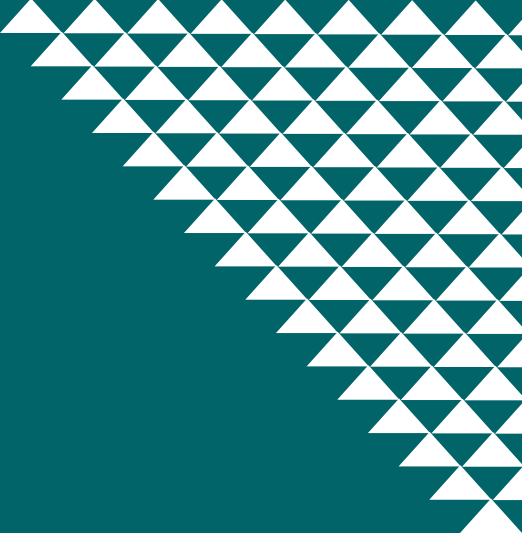


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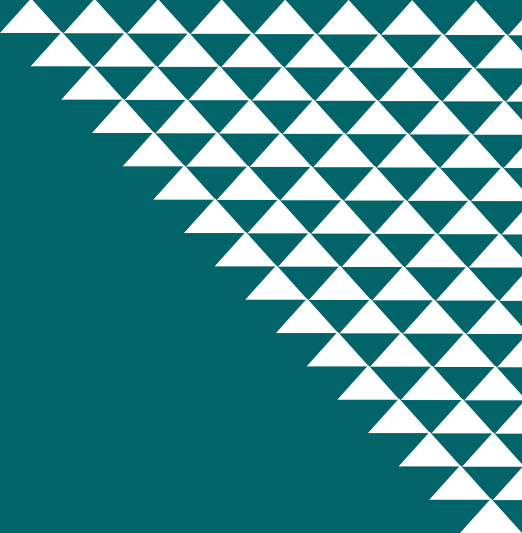
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This guide has been prepared to assist members and firms in understanding and applying the new independence standard. **It is neither a definitive analysis of the new standard nor a substitute for a careful reading of it.** Members must read the new standard to determine how it will apply to their own specific circumstances. In doing so, discussion with a professional colleague or a representative of a provincial institute may be of assistance and is encouraged.



# 1.0

## INTRODUCTION

### GUIDE to *New Canadian Independence Standard*

It is a fundamental principle of the practice of Chartered Accountancy that a member who provides assurance services shall do so with unimpaired professional judgment and objectivity, and shall be seen to be doing so by a reasonable observer. This principle is the foundation for public confidence in the reports of assurance providers.

The confidence that professional judgment has been exercised depends on the unbiased and objective state of mind of the reporting accountant, both in fact and appearance. Independence is the condition of mind and circumstance that would reasonably be expected to result in the application by a member of unbiased judgment and objective consideration in arriving at opinions or decisions in support of the member's report.

CICA's Public Interest and Integrity Committee has issued its new independence standard for assurance providers in Canada, effective January 1, 2004. The new standard emphasizes 'independence' because this term has gained general acceptance internationally. In developing this new standard, the Committee consulted extensively with members, regulators, the provincial institutes and other stakeholders. The result is a modern standard that reflects the updated global standard recently issued by the International Federation of Accountants, along with the US SEC requirements for public companies.

The requirement for independence applies to all members and firms when they conduct an assurance engagement or a specified auditing procedures engagement (together referred to throughout this Guide as assurance engagements). New Rules of Professional Conduct 204.1 and following address professional engagements ranging from a sole practitioner's review of the financial statements of a small owner-managed business to a national firm's audit of a large multi-national corporation.

Independence and objectivity requirements for the CA profession are not new. The requirement for objectivity in an assurance engagement remains the same, with independence being the critical criterion.

What is new is the systematic, principles-based framework for analyzing independence for each prospective assurance engagement, including new types of service that may emerge. It thus becomes a "living" standard.



1.0

## INTRODUCTION

### GUIDE to *New Canadian Independence Standard*

This framework introduces the positive requirement for members and firms to:

- a) Consider independence before and throughout each assurance engagement;
- b) Consider whether any “threats” to independence exist;
- c) Where threats are identified, consider whether there are “safeguards” that exist or may be applied to eliminate the threat or reduce it to an acceptable level;
- d) Where safeguards are found to be inadequate, decline or discontinue the engagement; and
- e) Notwithstanding the analysis of threats and safeguards, consider whether there are any “prohibitions” that would preclude the undertaking or completion of the proposed engagement.

Each of these concepts is discussed in more detail later in this Guide.

The new standard also provides significantly more guidance than the previous Council Interpretation which will assist members and firms in applying the framework and remaining independent when required. This guidance is supplemented by many examples of the common circumstances encountered in practice along with a lengthy list of definitions of the terms used throughout the standard.



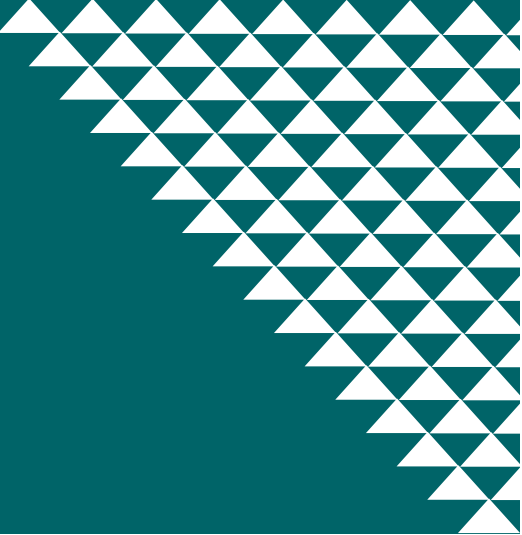
## 2.0

## OVERVIEW OF INDEPENDENCE STANDARD

### GUIDE to *New Canadian Independence Standard*

Rule 204.1 requires a member or firm who performs an assurance engagement to be independent of the client. When independence is required for a particular engagement, the member or firm must:

1. Identify threats to independence. Threats may be categorized as:
  - ▲ self-interest
  - ▲ advocacy
  - ▲ intimidation
  - ▲ familiarity
2. Evaluate the significance of the threats identified. For each threat that is not clearly insignificant, determine if there are safeguards that can be applied to eliminate the threat or reduce it to an acceptable level. Possible safeguards include:
  - ▲ professional, legislative, or regulatory safeguards
  - ▲ safeguards within the entity
  - ▲ safeguards within the firm
3. Determine if there are prohibitions that preclude performing the engagement. Examples of prohibitions are:
  - ▲ financial interests in client
  - ▲ loans and guarantees to or from client
  - ▲ close business relationships with client
  - ▲ family and personal relationships with client
  - ▲ future or recent employment with client
  - ▲ serving as officer, director or company secretary of client
  - ▲ providing non-assurance services to client
  - ▲ making management decisions for client
4. For each threat identified as not clearly insignificant, document
  - ▲ a description of the nature of the engagement
  - ▲ the threat identified
  - ▲ a description of the safeguard applied to eliminate the threat or reduce it to an acceptable level and
  - ▲ an explanation of how the safeguard eliminates the threat or reduces it to an acceptable level.



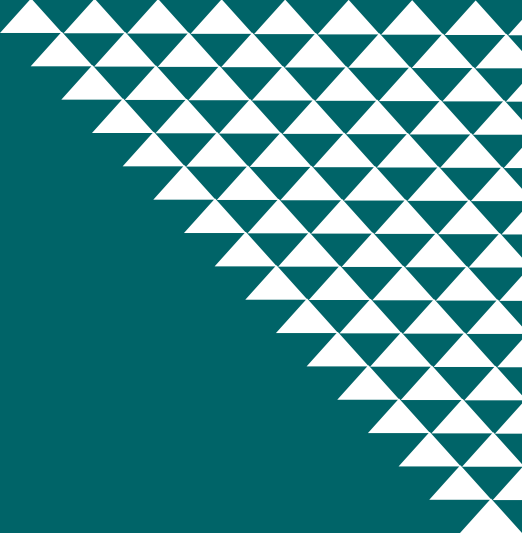
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## OVERVIEW OF INDEPENDENCE STANDARD

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Once threats to independence have been identified, safeguards applied to reduce the threats to an acceptable level, there are no prohibitions that would preclude performing the engagement, and the process has been documented the member or firm may proceed with the assurance engagement.

The flowchart on the following page illustrates the steps that must be taken.

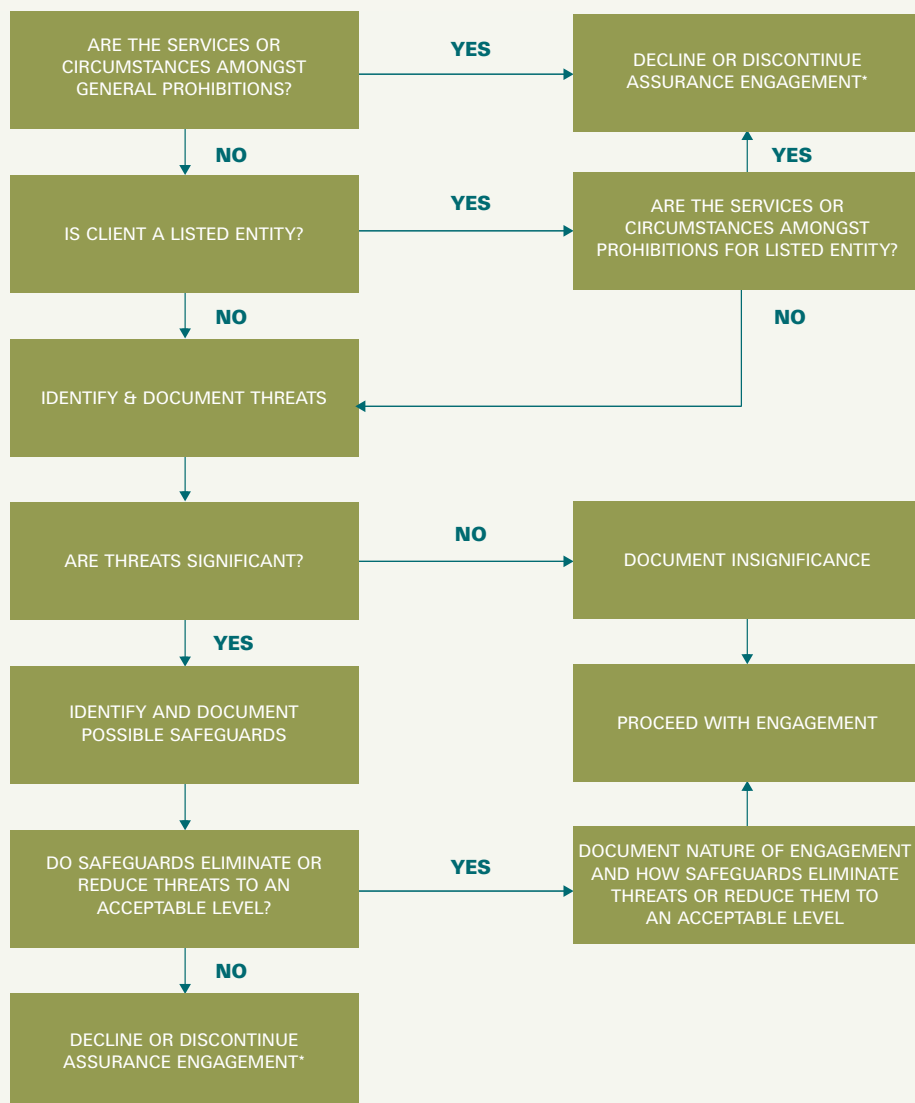


2.0

## OVERVIEW OF INDEPENDENCE STANDARD

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#### OVERVIEW OF INDEPENDENCE STANDARD — FLOWCHART



\* Consider whether compilation engagement will meet client's needs and if so, disclose nature and extent of lack of independence in the Notice to Reader.





# 3.0

## THREATS TO INDEPENDENCE

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As noted in the Introduction, threats to independence must be considered before and during an assurance engagement. There are five categories of threat to independence.

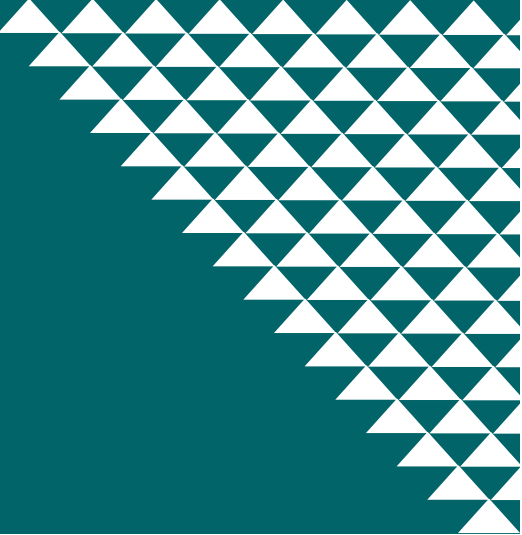
A **Self-Interest Threat** occurs when a firm or a person on the engagement team could benefit from a financial interest in, or another self-interest conflict with, an assurance client. Circumstances that may create a self-interest threat include having a direct financial interest or material indirect financial interest in the assurance client.

A **Self-Review Threat** occurs when any product or judgment from a previous engagement needs to be evaluated in reaching conclusions in the particular assurance engagement. Circumstances that may create a self-review threat include there being a person on the engagement team being, or having recently been, an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the engagement.

An **Advocacy Threat** occurs when a firm, or a person on the engagement team, promotes an assurance client's position or opinion to the point that objectivity may be, or may be perceived to be, impaired. This would occur if the judgment of a person on the engagement team were to be subordinated to that of the client. Circumstances that may create an advocacy threat include the dealing in, or being a promoter of, shares or other securities of the assurance client.

A **Familiarity Threat** occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a person on the engagement team becomes too sympathetic to the client's interests. Circumstances that may create a familiarity threat include there being a person on the engagement team having an immediate or close family member who is a director or officer of the assurance client.

An **Intimidation Threat** occurs when a person on the engagement team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client. Circumstances that may create an intimidation threat include the threat of being replaced due to a disagreement with the application of an accounting principle.



## 3.0

## THREATS TO INDEPENDENCE

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Members and other readers are referred to paragraphs 40 to 44 of the Council Interpretation for more examples of threats in each of the five categories that must be considered when analyzing independence.

In identifying threats to independence, care must be taken as threats are not always direct or overt and, in many cases, they can be quite subtle. Consideration must always be given to the public perception of a threat. The public perception is that of the **“reasonable observer — a hypothetical individual who has knowledge of the facts, which the member knew or ought to have known, and applies judgment with integrity and due care.”** Often it is the reasonable observer’s perception of a threat that is most important and presents the most complexity in determining whether one is independent.



## 4.0

## SAFEGUARDS

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Safeguards are those factors or circumstances that members and firms must identify and apply to eliminate a threat to independence or reduce it to an acceptable level. There are three categories of safeguard.

**Safeguards created by the profession, legislation or regulation** include:

- a) Education, training and practical experience requirements for entry into the profession;
- b) Continuing education programs;
- c) Professional standards;
- d) External practice inspection;
- e) Disciplinary processes;
- f) Members' practice advisory services;
- g) Participation by members of the public in oversight and governance of the profession; and
- h) Legislation governing the independence requirements of the firm and its members.

**Safeguards within the assurance client** include:

- a) Employees of the client who are competent to make management decisions;
- b) Client policies and procedures that emphasize the client's commitment to fair financial reporting;
- c) Internal procedures that ensure objective choices in commissioning non-assurance engagements; and
- d) An audit committee, comprised of qualified individuals, that provides appropriate oversight and communications regarding a firm's services.

**Safeguards within the firm's own systems and procedures** include:

- a) Firm-wide safeguards, which are primarily in the nature of policies, procedures and the like, which promote a high degree of awareness and compliance with the requirements for independence; and
- b) Engagement-specific safeguards, which include, for example, third party consultations, rotation of senior personnel, discussions with audit committees, etc.



## 4.0

## SAFEGUARDS

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Some safeguards, such as practice inspection, are structural or environmental because they remain in the background of a member's thinking. Others, such as removing a particular member from the engagement team, are specifically applicable in appropriate circumstances.

Paragraphs 50 and 51 of the Council Interpretation contain several examples of firm-wide and engagement-specific safeguards which members and firms must consider when they encounter threats in respect of a particular engagement for which independence is required.

#### **SOLE PRACTITIONERS AND SMALL FIRMS**

Resource and other constraints may mean that many of the firm-wide and other safeguards are not available to sole practitioners and smaller firms. This is addressed in Paragraph 52 of the Council Interpretation as follows:

*“The size and structure of the firm and the nature of the assurance client and the engagement will affect the type and degree of the threats to independence and, consequently, the types of safeguards appropriate to eliminate such threats or reduce them to an acceptable level. For example, it is understood that not all the safeguards noted in paragraphs 50 and 51 will be available to the sole practitioner or small firm or within smaller clients such as owner-managed entities. Smaller clients often rely on members to provide a broad range of accounting and business services. Independence will not be impaired provided such services are not specifically prohibited by Rule 204.4 and provided safeguards are applied to reduce any threat to an acceptable level. In many circumstances, explaining the result of the service and obtaining client approval and acceptance for the result of the service will be an appropriate safeguard for such smaller entities. Similarly, such clients often have a long-standing relationship with an individual who is a sole practitioner or partner from a firm. Independence will not be impaired provided safeguards are applied to reduce any familiarity threat to an acceptable level. In most circumstances, periodic external practice inspection and, where appropriate, consultation will reduce any threat to independence to an acceptable level.”*



## 5.0

## PROHIBITIONS

### GUIDE to *New Canadian Independence Standard*

Rule 204.4 describes circumstances and activities, which members and firms must avoid when performing an assurance engagement because adequate safeguards will not exist that will, in the view of a reasonable observer, eliminate a threat or reduce it to an acceptable level. The requirements to avoid these circumstances and activities are referred to as “prohibitions”.

Prohibitions are not new per se. The council interpretation to the prior Rule 204.1 contains numerous examples of circumstances where a member was not permitted to perform an assurance engagement. The prohibitions are now listed in the Rules of Professional Conduct (Rule 204.4). Members will find further guidance and examples with respect to the prohibitions in the Council Interpretation that follows the rules.

Some prohibitions will apply to **all assurance clients** while others will only apply to **audits of public companies**. Many of the prohibitions applicable to all assurance clients were addressed in the earlier council interpretation. The new prohibitions applicable to audits of listed entities were developed having regard to the current expectations of securities regulators and investor groups.

The prohibitions may be summarized as follows:

#### PROHIBITIONS APPLICABLE TO ASSURANCE ENGAGEMENTS FOR ALL CLIENTS

1. Members of the engagement team (and immediate family members) may not have a financial interest, as defined, in an assurance client or a related entity. This is extended to network firms (also defined) in the case of audit clients. Non-engagement team members of the firm (and immediate family) are prohibited from owning more than 0.1% of an audit or review client.
2. The firm and members of the engagement team may not have a loan, or a loan guarantee, to or from an assurance client or a related entity. There are limited exceptions for loans that are made in the ordinary course of a bank client's business.
3. The firm and members of the engagement team may not have a close business relationship with an assurance client, **unless** the relationship is limited to an immaterial financial interest that is insignificant to the client, the firm or the member.



## 5.0

## PROHIBITIONS

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4. Members of the engagement team may not have an immediate family member in a position with the client where that person would be able to influence the subject matter of the assurance engagement.
5. Members of the engagement team must not be an officer or director of the client, or an employee of the client in a position to influence the subject matter of the assurance engagement, during the period covered by the engagement. As well, other members of the firm may not be officers or directors of an assurance client.
6. Members and firms are prohibited from performing management functions (as described) for an assurance client.
7. Members and firms must obtain client management approval for the making of journal entries, accounting classifications, etc. The creation of original or source documents such as cheques, invoices, etc. is prohibited. (These matters are discussed in greater detail in paragraphs 134 to 143 of the Council Interpretation.)
8. Members and firms may not provide legal services that involve dispute resolution of matters that are material to the financial statements of audit and review clients.
9. Members and firms may not provide corporate finance services such as dealing in, promoting, or buying/selling an assurance client's securities.
10. A member or firm may not provide an assurance service to a client for a fee that is significantly lower than market ("low ball") unless the member can demonstrate that all professional standards have been met in performing the service.
11. Members and students on the engagement team and the firm may not accept other than insignificant gifts or hospitality from an assurance client.

#### **PROHIBITIONS APPLICABLE TO AUDITS OF PUBLIC COMPANIES ONLY**

1. A former member of the audit team may not take a senior financial position with the client for one year.
2. Audit partners must take leave of the audit team in accordance with the rotation requirements described in Rule 204.4 (20).
3. The client audit committee must pre-approve all services provided by the firm to the client.
4. Audit partners may not be directly compensated by the firm for selling non-assurance services to their audit clients.



# 5.0

## PROHIBITIONS

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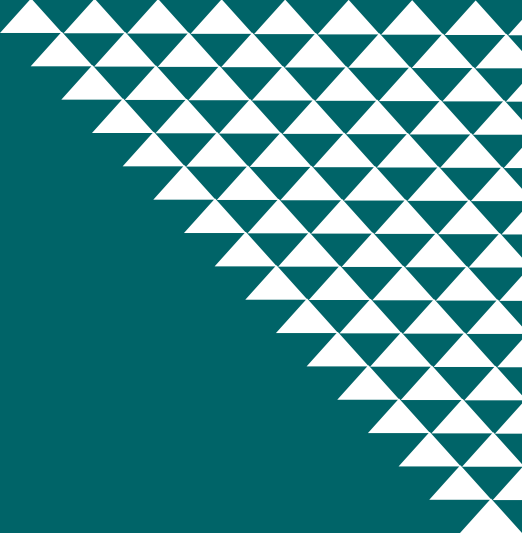
5. Members and firms may not provide:
  - ▲ Bookkeeping and accounting services;
  - ▲ Financial information systems design and implementation;
  - ▲ Actuarial services;
  - ▲ Valuation services;
  - ▲ Internal audit servicesunless it is reasonable to conclude that the results of the services will not be subject to audit procedures.
6. Members and firms may not provide the following services, even if not subject to audit:
  - ▲ Expert services including litigation support;
  - ▲ Legal services;
  - ▲ Management functions;
  - ▲ Human resources services;
  - ▲ Corporate financial services.

Public companies are referred to in the standard as “**listed entities**”. A listed entity is defined in the standard to be an entity whose shares or debt are quoted or listed on a recognized stock exchange, **other than** an entity that has market capitalization and book value of total assets that are both less than \$10 million.

An entity that meets the definition will be considered to be a listed entity until:

- ▲ its securities cease to be quoted or listed, or
- ▲ its market capitalization and total assets have fallen below the \$10 million threshold for two years.

The “prohibitions” listed above are only relevant if the member or firm proposes to perform an audit or other assurance engagement for a client. Members and firms must always remember that the failure to observe a particular prohibition will mean that the member or firm will not be independent of the client for an audit or assurance engagement, and will therefore be prohibited from performing the assurance engagement.



## 6.0

## APPLICATION OF THE FRAMEWORK

### GUIDE to *New Canadian Independence Standard*

The Council Interpretation to Rules provides detailed guidance on the application of the framework and contains examples that describe threats created and safeguards that may be appropriate to eliminate them or reduce them to an acceptable level.

The following examples demonstrate the application of the framework:

#### **EXAMPLE 1 — BOOKKEEPING SERVICES**

A practitioner has an engagement to review the financial statements of an owner-managed entity. The client's bookkeeper maintains the disbursements and receipts journal but does not understand accrual accounting. Consequently, the client relies on the practitioner to provide bookkeeping assistance to prepare the financial statements. Does the provision of this assistance impair the practitioner's independence?

#### **Does Rule 204 prohibit the activity?**

Rule 204.4(24) states that a member shall not prepare or change a journal entry or change an account code of a transaction or prepare or change another accounting record without obtaining management approval.

The sole practitioner would need to obtain the approval of the client. The practitioner could either sit down with the client to explain the purpose of each journal entry made or alternatively the practitioner could obtain approval through the management representation letter.

Having ensured compliance with any specific rule the practitioner must consider whether there is still a threat to independence. Applying the framework the practitioner would answer the following questions:

#### **Does the provision of the bookkeeping services create a self-interest, self-review, advocacy, familiarity or intimidation threat?**

The only threat created is a self-review threat because the practitioner is preparing the journal entries and therefore will be in a position of reviewing his or her own work.





## 6.0

## APPLICATION OF THE FRAMEWORK

### GUIDE to *New Canadian Independence Standard*

#### **How significant is the threat? Is it other than clearly insignificant?**

If the journal entries are simple in nature, for example to record depreciation, accounts receivable, accounts payable and taxes the threat would be clearly insignificant. None of these entries require the application of complex accounting standards. Consequently, no safeguards would be necessary.

If the client had a transaction during the year for which the accounting was complex, involved significant judgment and the practitioner had not encountered this type of transaction before, the self-review threat created would be significant. The practitioner would have to apply safeguards to eliminate the threat or reduce it to an acceptable level. One way to achieve this would be to consult with another professional accountant to confirm the accounting treatment proposed. If, based on the discussions with the other professional accountant, the practitioner is satisfied that the accounting treatment adopted is appropriate, the self-review threat will have been reduced to an acceptable level.

#### **EXAMPLE 2 — VALUATION SERVICES**

A practitioner is asked by an audit client, which is a private company, to perform a valuation service. Does the provision of the valuation service impair the practitioner's independence?

#### **Does Rule 204.4 prohibit the activity?**

Rule 204.4 does not contain any specific prohibitions related to valuation services for a private company.

#### **Does the provision of the valuation service create a self-interest, self-review, advocacy, familiarity or intimidation threat?**

The service does not create a self-interest, familiarity or advocacy threat. If the valuation does not affect the financial statements there will be no self-review threat. However, if it does affect the financial statements, a self-review threat will be created because the practitioner will be in a position of auditing his or her own work.



## 6.0

## APPLICATION OF THE FRAMEWORK

### GUIDE to *New Canadian Independence Standard*

#### **How significant is the threat? Is it other than clearly insignificant?**

In determining the significance of the threat the practitioner would consider the following:

- ▲ Whether the valuation is material to the financial statements;
- ▲ Whether the valuation involves significant judgement — for example, it may be dependent on future events that are uncertain; and
- ▲ Whether the client will be involved with the service and the assumptions to be applied.

#### **Possible safeguards to be applied**

If the practitioner concludes that the threat is other than clearly insignificant, safeguards should be applied to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- ▲ Involving another professional accountant who was not a member of the engagement team to review the work performed;
- ▲ Confirming with the client its understanding and approval of the underlying assumptions and methodology used in the valuation;
- ▲ Obtaining the client's acknowledgement of the responsibility for the results of the valuation work performed by the practitioner; and
- ▲ Ensuring that the person who performs the valuation work does not participate on the engagement team.



## 7.0

## FREQUENTLY ASKED QUESTIONS

### GUIDE to

### *New Canadian Independence Standard*

#### QUESTION 1:

**I am a sole practitioner with no public company clients and the majority of my practice is review engagements and tax work. What is the most significant change in these standards for me?**

#### ANSWER:

The most significant change for you is the thought process that needs to be applied on every assurance engagement. You will need to consider whether there are threats to independence and, if so, you will need to apply safeguards to eliminate the threats or reduce them to an acceptable level.

#### QUESTION 2:

**I am a partner in a large firm and my clients are predominately large public companies. What is the most significant change in these standards for me?**

#### ANSWER:

In addition to the thought process that needs to be applied on every assurance engagement, the most significant change for you is the new prohibitions on the provision of non-assurance services and the new partner rotation requirements.

#### QUESTION 3:

**I practice in a small town where I often socialize with my clients. When will this become a familiarity threat to my independence?**

#### ANSWER:

There is no simple answer to this question as threats to independence are often about perception as well as actual impairment. Socializing with clients is usually not a problem unless the practitioner is seen together with the client so often that the rest of the community may view the member as becoming too close to the client and the relationship as no longer being on just a professional level.

#### QUESTION 4:

**I have many small clients who have difficulty with their bookkeeping and I am required to make many adjusting entries as a part of my year-end review in addition to drafting the financial statements and notes. Am I still able to do that?**



## 7.0

## FREQUENTLY ASKED QUESTIONS

### GUIDE to

### *New Canadian Independence Standard*

#### ANSWER:

Members may prepare journal entries and financial statements for audit or review clients that are not listed entities as long as they can reduce the self-review threat to an acceptable level. This can be accomplished by having the client's management approve the journal entries during a thorough review of the financial statements with the client, or by the client's management approving the financial statements. This approval may also be specifically included in the management representation letter. Members should review Paragraphs 134 to 143 of the Council Interpretation for additional guidance.

#### QUESTION 5:

**I am a sole practitioner and many of my clients are owner-managed enterprises who rely on me to help them record complicated accounting transactions, such as foreign currencies and leases. Can I still do that?**

#### ANSWER:

It is Council's view that providing technical assistance to clients is an appropriate method of promoting fair presentation of the financial statements. However, if the member is required to prepare a journal entry to record a material complex transaction, the client's lack of accounting knowledge may mean that simply reviewing the journal entry with the client is not sufficient to reduce the self-review threat to an acceptable level. Unless the sole practitioner consults with another CA, such as a member of another firm or an Institute practice advisor, on the accounting for the complex transaction, the member will not be able to perform the assurance engagement for this client. Members are urged to review Paragraphs 141 to 143 of the Council Interpretation for additional guidance.



## 7.0

## FREQUENTLY ASKED QUESTIONS

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#### QUESTION 6:

**Our firm is working with CCRA on behalf of our audit client in the resolution of a proposed re-assessment of prior years income taxes. We are in the midst of our audit of the financial statements and the amounts involved in the proposed re-assessment are material to these statements. Is our independence threatened such that we must resign from the audit engagement?**

#### ANSWER:

There may be an advocacy threat but most often, the answer to this question will be “No, your independence is not threatened such that your firm may not complete the audit engagement.” This issue is addressed in Paragraphs 188 and 189 of the Council Interpretation. The interpretation notes that taxation services are unique among non-assurance services for several reasons. Detailed tax laws must be consistently applied and CCRA has discretion to audit any tax filing. Accordingly such engagements are generally not seen to create any threats to independence that are not adequately offset by available safeguards.

#### QUESTION 7:

**Our private company audit client (a group of related companies) routinely requests the engagement partner to accompany them to the bank to review with the banker the group’s financial statements and the covenant calculations related to the bank financing provided to the group. Can we provide this service and maintain our independence?**

#### ANSWER:

There may be an advocacy or self-review threat but the answer to this question will often be “yes”. Provided the discussion with the bank manager is restricted to facts, whereby the partner provides explanations as necessary, it is unlikely that a threat to independence would be created. The partner should exercise care to ensure that he or she is not perceived to be encouraging the banker to take a particular viewpoint with respect to any ongoing financing to the client.



## 7.0

## FREQUENTLY ASKED QUESTIONS

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#### QUESTION 8:

**My audit client, a private company, has asked if I can lend him one of my staff members for three days per week to fill in for his controller who is on maternity leave. The duties my staff member will be performing include preparing monthly financial statements for the bank and she will be one of two signing officers on the company cheques. My staff member will likely also be involved in negotiating the financing for the purchase of a new large piece of equipment. Will this arrangement affect my independence when it comes time to do the audit?**

#### ANSWER:

Paragraph 132 of the Council Interpretation states that this type of assistance may be provided only when the person loaned is not involved in making management decisions, approving or signing agreements or other documents or exercising discretionary authority to commit the client. In this particular situation, the staff member has too much involvement in management activities and the CA's independence will likely be impaired.

#### QUESTION 9:

**How do I determine if my public company clients listed on the TSX Venture Exchange meet the definition of a "listed entity" for the year ended December 31, 2005?**

#### ANSWER:

A listed entity is defined to be an entity that has market capitalization or total assets over \$10 million in respect of a particular fiscal year. Once an entity is considered to be a listed entity, it remains so classified unless, and until, it ceases to have its shares or debt quoted, listed or marketed in connection with a recognized stock exchange or the entity has stayed under the threshold for a period of two years.

# 7.0

## FREQUENTLY ASKED QUESTIONS

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The calculation of “market capitalization” for a particular fiscal year is the average market price of all outstanding listed securities and publicly traded debt of the entity measured at the end of each of the first, second and third quarter of the prior fiscal year and the year-end of the second prior fiscal year. “Total assets” refers to the net book value of the total assets of the entity at the end of the third quarter of the prior year.

#### EXAMPLE

ABC Ltd.  
Year ending December 31, 2005  
(Calculation performed on January 1, 2005)

Total assets on September 30, 2004: \$ 9,200,000

Market capitalization based on 1 million outstanding shares in total with average price at end of each quarter noted below:

December 31, 2003	\$ 9.75	\$ 9,750,000
March 31, 2004	\$10.25	10,250,000
June 30, 2004	\$10.15	10,150,000
September 30, 2004	\$ 9.95	<u>9,950,000</u>
Total		<u>\$40,100,000</u>
Average		<u>\$10,025,000</u>

Client is defined as Listed Entity for 2005.

#### QUESTION 10:

**One of my client’s is planning to go public. How do I determine if the client will meet the definition of a “listed entity” after it has gone public?**



## 7.0

## FREQUENTLY ASKED QUESTIONS

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#### ANSWER:

An entity is defined to be a listed entity if it has either market capitalization or total assets in excess of \$10,000,000. In the case of an entity that makes a public offering market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements that are included in the public offering document.

XYZ Ltd has a December 31 year-end and goes public on August 31, 2005. The public offering document contains audit financial statements for the years ended December 31, 2002, 2003 and 2004 and reviewed financial statements for the six-month period ended June 30, 2005. XYZ issues 6,500,000 at an offering price of \$1.50 and the closing price on August 31, 2005 has risen to \$1.60.

#### TOTAL ASSETS ON

December 31, 2002	\$ 6,545,000
December 31, 2003	7,863,000
December 31, 2004	7,912,000
June 30, 2005	7,834,000

#### MARKET CAPITALIZATION

Opening price	6,500,000 shares at \$1.50	\$ 9,750,000
Closing price	6,500,000 shares at \$1.60	\$10,400,000

XYZ Ltd is considered to be a listed entity because the market capitalization at the end of the day of the public offering is in excess of \$10,000,000.

When a client contemplates its initial public offering it may not be able to estimate its market capitalization on the offering date with any degree of accuracy. Members and firms should take appropriate steps to ensure compliance if it is possible the \$10 million threshold will be exceeded. If it appears that the market capitalization might exceed \$10 million, the member or firm who had been providing bookkeeping services to the client should ensure the client understands that such services could no longer be provided.





## 7.0

## FREQUENTLY ASKED QUESTIONS

### GUIDE to

### New Canadian Independence Standard

#### QUESTION 11:

**Our firm is the auditor of an entity listed on the TSX Venture Exchange with assets of \$15 million. In the midst of our audit, we have encountered significant difficulties with the accounting treatment and disclosure related to financial instruments and stock based compensation. The client's staff requires assistance to deal with these situations adequately. What role can the firm have in resolving the problems without compromising our independence?**

#### ANSWER:

Paragraph 138 of the Council Interpretation discusses the circumstance in this question. It says in part

*"... the financial statement audit and review process involves extensive dialogue between persons on the engagement team and management of the audit or review client. During this process, management will often request and receive input regarding such matters as accounting principles and financial statement disclosure..."*

It goes on to say

*"The provision of technical assistance of this nature for an audit or review client is an appropriate method of promoting the fair presentation of the financial statements. The provision of such advice, per se, does not generally threaten the member's or the firm's independence."*

Thus, the firm can provide advice and technical assistance related to the identified problems. However, there should be clearly documented evidence that decisions related to the resolution of the circumstances were made by management, **not** the auditors.



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