

Public Practice Advisory

November 2015

Focus On Practice Review Reportable Deficiencies 2014-15

BACKGROUND

The objective of practice inspection that has been adopted by the provincial accounting bodies is “the protection of the public by assessing the compliance with professional standards of members/firms that perform assurance, compilation and other specified engagements, and by taking appropriate follow-up or remedial action in instances of non-compliance. The public is further protected by practice review providing an educational experience to members/firms.”

The unified bodies have adopted a harmonized evaluation methodology across the country. The harmonized methodology provides for a consistent approach to practice review in all provinces and the use of consistent terminology throughout. Harmonization allows the provincial bodies to monitor statistics such as common deficiencies, practice review results, etc., across the country and identify areas where improvements, training, etc., could be required.

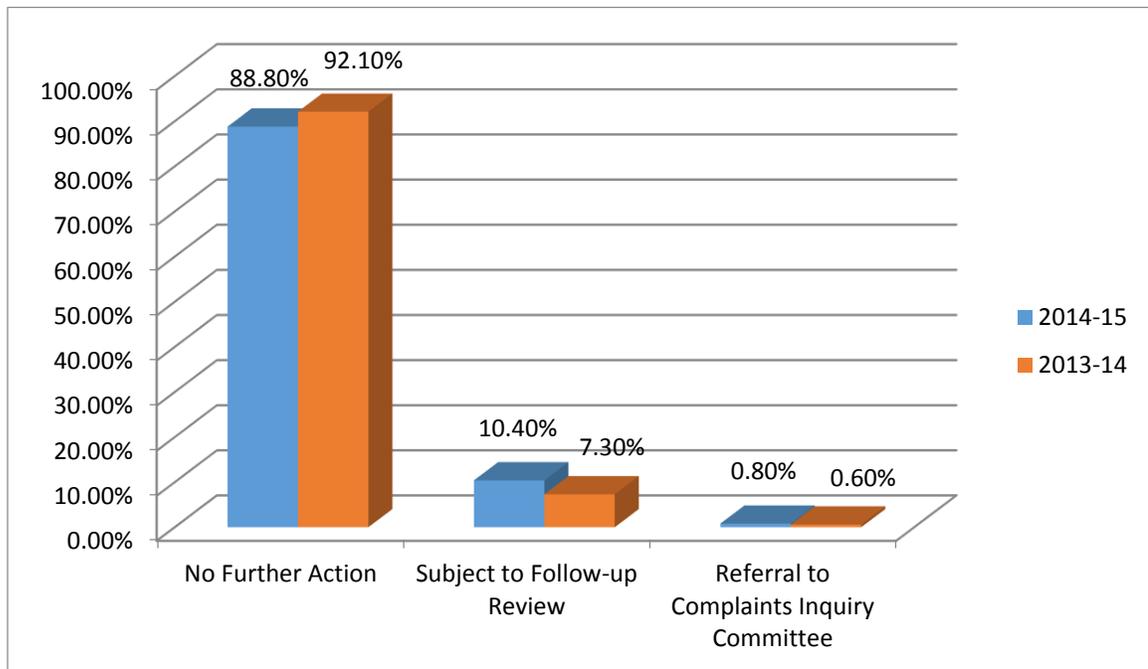
Reviewed offices are provided with matters identified during the course of the review as either reportable deficiencies (reportable to the Practice Review Committee) or non-reportable matters (items brought only to the attention of the reviewed office and not to the Committee). In the circumstances of reportable deficiencies, a reviewed office will have the opportunity and is strongly encouraged to respond to the Practice Review Committee by stating how it will address the reportable deficiencies identified by the reviewer. The Practice Review Committee will then assess the reportable deficiencies and the office’s response to determine if any further action is required.

Public Practice Advisories are published on issues of particular relevance to members in public practice. Any queries regarding this specific advisory should be directed to Wayne Wasylyshyn, CPA, CA, Director of Practice Review, at wwasylyshyn@cpaalberta.ca. General questions on advisories or other issues related to professional services should be directed to Larry Brownoff, CPA, CA, Director, Professional & Career Services at lbrownoff@cpaalberta.ca. For additional copies of this advisory, contact Chris Pilger, Director, Member Communications at cpilger@cpaalberta.ca or 1-800-232-9406 or (780) 420-2363.

The Practice Review Committee reviews the provincial annual review results as well as the common deficiencies determined from the national monitoring of statistics to identify those areas where adherence to the *CPA Canada Handbook* recommendations could be improved.

During the 2014-15 year (April 1, 2014 – March 31, 2015), 364 (455 in 2013-14) public practices were reviewed, of which:

- 88.8% resulted in the Committee requiring no further action or only the submission of an acceptable action plan response from the office (92.1% in 2013-14);
- 10.4% resulted in the Committee requiring a follow-up review of the office (7.3% in 2013-14);



- 0.8% resulted in the Committee referring a member to the Complaints Inquiry Committee for its independent assessment (0.6% in 2013-14).

Of the 210 practice reviews completed to date in the 2015-16 review cycle, there is a modest improvement over the 2014-15 findings.

This communication outlines the common reportable deficiencies in the areas of financial statement presentation; documentation of audit, review and compilation engagements; and documentation and implementation of quality control policies and procedures noted during the 2014-15 review cycle. The memo also highlights upcoming changes and current projects which practitioners should be aware of in planning for upcoming engagements.

To assist practitioners in finding guidance on current and upcoming standards, the appendices list helpful resources and tools that can be used to obtain an understanding of and comply with the various requirements.

FINANCIAL STATEMENT PRESENTATION

CPA Canada Handbook – Accounting, Part II: Accounting Standards for Private Enterprises (ASPE)

The common deficiencies in the 2014-15 practice review cycle related to financial statement presentation that continue to exist include the following:

- Disclosure in the notes that the financial statements are prepared in accordance with Canadian accounting standards for private enterprises (Part II, Section 1400.16);
- Related party transactions – disclosure of terms and conditions, nature and extent of transactions, description of relationship and the measurement basis used (Part II, Section 3840.51);
- Significant risks arising from financial instruments - disclosure of the nature and extent of financial instruments, and credit risk, interest rate risk, currency risk and fair value, if considered a significant risk for the entity (Part II, Section 3856. 53, A66);
- Significant accounting policies:
 - Revenue recognition policy disclosure for each type of material type of revenue transaction (Part II, Section 3400.31);
 - Policy used to account for income taxes - when the income taxes payable method has been adopted by the entity, the disclosures should include a reconciliation of the income tax rate/expense related to the income or loss for the period, the amount and timing of capital gain reserves and similar reserves to be included in taxable income within five years, the amount of unused income tax losses carried forward and unused income tax credits, and the portion of income tax expense (benefit) related to transactions charged (or credited) to equity (Part II, 3465.88);
 - Policy adopted in determining composition of cash and cash equivalents (Part II, Section 1540.43); and

- Accounting policies adopted in measuring inventories, including the cost formula used for all inventories held (Part II, Section 3031.35).
- Issued share capital – Part II, Section 3240 sets out disclosure requirements for issued share capital. Practitioners should also be mindful of the presentation and disclosure requirements with respect to **preferred shares issued in a qualifying tax planning arrangement**, as set out in Part II, Sections 3856.23 and .47. If the preference shares are not issued in connection with a tax planning arrangement, determination must be made of the classification of the shares as either a financial liability or equity. The number of shares of each class together with a description and par value (if any) should be disclosed. Disclosure of the dividend rate on preference shares together with the redemption price of redeemable shares is also required;
- Receivables, including related party amounts with no terms of repayment – inappropriately classified as a current asset. Part II 1510.03 requires the classification as a current asset only when the receivable is ordinarily realizable within one year from the date of the balance sheet, or within the normal operating cycle when it is longer than one year. Receivables with no set terms of repayment and that will not be realized within one year from the balance sheet date **must be classified as a long-term asset**;
- Debt due on demand, **including related party debt**, inappropriately classified as long-term debt. Per Part II, Section 1510.13, non-current classification of debt is based on facts existing as at the balance sheet date, rather than on expectations regarding future refinancing or renegotiation. If the creditor has at the balance sheet date, or will have within one year (or within one operating cycle, if longer) from that date, the unilateral right to demand immediate repayment of any portion or all of the debt under any provision of the debt agreement, the obligation is classified as a **current liability** unless:
 - a. the creditor has waived, in writing, or subsequently lost, the right to demand payment for more than one year (or operating cycle, if longer) from the balance sheet date;
 - b. the obligation has been refinanced on a long-term basis before the balance sheet is completed; or
 - c. the debtor has entered into a non-cancellable agreement to refinance the short-term obligation on a long-term basis before the balance sheet is completed and there is no impediment to the completion of the refinancing.
- Long-term debt – disclosure was found to be deficient in relation to maturity dates, interest rates and repayment terms. Additionally, entities did not disclose the carrying value of assets pledged as security for liabilities (Part II 3856.43-.44); and
- Guarantees – disclosure of the nature and term of the guarantee was adequate in some cases; however, the maximum potential amount of future payments, the current carrying amount of the obligation, the nature of recourse provisions by the guarantor and the nature of assets held as collateral were not always disclosed (Part II AcG-14).

First-time Adoption of ASPE

The requirements for first-time adoption of ASPE must be applied to all entities reporting under these standards for the first time, not just the enterprises that converted from Part V GAAP back in 2011. This would be the case for entities that have switched from a compilation engagement

to a review engagement or audit engagement, or in cases where the statements were previously prepared under another acceptable framework. Section 1500 in Part II of the CPA Canada Handbook – Accounting provides guidance for first-time adoption of ASPE at any time.

In 2011, when private businesses transitioned from Part V GAAP to ASPE, there were many cases where there was not any required adjustments to figures in the financial statements or note disclosures because ASPE was very similar to Part V GAAP with differential reporting options. However, this might not be the case for entities going from non-GAAP financial statements to ASPE.

Non-GAAP financial statements typically do not include a cash flow statement and tend to have few or no note disclosures. As well, many of the recognition, measurement, and presentation requirements of ASPE are often not reflected in non-GAAP financial statements. As a result, the work necessary for first-time ASPE adoption from non-GAAP statements will likely differ considerably from what was required to transition from Part V GAAP to ASPE.

Upcoming Changes

The 2015 Annual Improvements material has been approved and is expected to be issued before the end of the year. The revisions affect the following sections: Business Combinations (Section 1582), Investments and Leases (Sections 3051 and 3065) and Employee Future Benefits (Section 3462). These amendments, which are to be applied retrospectively, will be effective for years beginning on or after January 1, 2016 with earlier application permitted.

Current Projects

The Accounting Standards Board (AcSB) has numerous active projects including:

- *Accounting for Agricultural Assets* – a discussion paper has been approved and is expected to be issued before the end of the year. The issues addressed include: when a biological asset should be recognized, how it should be measured on initial recognition and in subsequent periods, and how agricultural produce at the point of harvest should be accounted for and required disclosures;
- *Accounting for Redeemable Preferred Shares Issued in a Tax Planning Arrangement* – an Exposure Draft was issued during the fourth quarter of 2014 regarding accounting for redeemable preferred shares issued in a tax planning arrangement commonly known as an “estate freeze.” The proposal would see these shares treated in the same manner as any other redeemable preferred shares – i.e., as a financial liability. The AcSB will be deliberating the comments received during the fourth quarter of 2015; and
- *Subsidiaries and Investments* – the AcSB recently issued an Exposure Draft, *Subsidiaries and Investments*, with a comment deadline of January 6, 2016. The Exposure Draft proposes to amend Subsidiaries (Section 1591) and Investments (Section 3051) in Part II of the CPA Canada Handbook – Accounting to clarify the accounting for a subsidiary and an investment subject to significant influence when the cost method is used.

Refer to <http://www.frascanada.ca/standards-for-private-enterprises/projects/active/item56206.aspx> for information on current projects.

CPA Canada Handbook – Accounting, Part III: Accounting Standards for Not-for-Profit Organizations (ASNFPO)

ASNFPO was introduced for adoption by not-for-profit organizations related to fiscal years beginning on or after January 1, 2012. An enterprise that prepares its financial statements in accordance with Part III must disclose that the financial statements have been prepared in accordance with Canadian Accounting Standards for Not-for-Profit Organizations. If desired, such entities may also make the additional statement that the financial statements are in accordance with Canadian GAAP.

The common deficiencies in the 2014-15 practice review cycle with respect to financial statement presentation that continue to exist include the following:

- Financial instruments – Part II 3856: the nature and extent of financial instruments and credit risk, interest rate risk, currency risk and fair value, if considered a significant risk for the entity were not always disclosed. Practitioners should be aware that Part II 3856 also applies to ASNFPO;
- Revenue recognition – Part III 4410: the accounting policy is not always disclosed, specifically with respect to revenue other than contributions. All entities are required to disclose the revenue recognition policy for each material type of revenue transaction;
- Deferral method – Part III 4410.54: a not-for-profit organization using the deferral method did not always disclose the nature and amount of changes in deferred contributions for the period;
- Preparation of cash flow statements – Part II 1400.03, 1540.03, Part III 4400.46: cash flow statements are now required under all accounting frameworks with the exception of Part IV – Pension Plans;
- Tangible capital assets – Part III 4431: were not amortized over the useful life of the tangible capital asset. Unless the not for profit organization meets the criteria of a small organization in Part III 4431.03, it should capitalize tangible capital assets. An organization that capitalizes its tangible capital assets **must** amortize them; and
- Description of the organization – Part III 4400: a clear and concise description of a not-for-profit organization's purpose, its intended community of service, its status under income tax legislation and its legal form were not always disclosed.

Current Projects

In April 2013, the AcSB in conjunction with the Public Sector Accounting Board (PSAB) issued a Statement of Principles (SOP). This SOP, titled *Improvements to Not-for-Profit Standards*, is applicable for both private not-for-profit organizations applying the *Handbook – Accounting Part*

III and government not-for-profits choosing to follow PS 4200. Private not-for-profits applying the *Handbook – Accounting Part I* (International Financial Reporting Standards) and government not-for-profits applying the *Handbook – Public Sector Accounting* without the PS 4200 series are not affected by this SOP.

The AcSB has undertaken the following projects in response to private sector stakeholder feedback to the SOP:

- *Accounting Standards Improvements* - this project will address the accounting for capital assets, excluding the size exemption, but including collections, works of art and historical treasures and similar items that are not part of a collection; accounting for intangible assets; and the disclosures of related party transactions and allocated expenses (Principles 5, 6, 8, 9, 12 and 15). An Exposure Draft is expected to be developed in the first half of 2016;
- *Reporting Controlled and Related Entities by Not-for-Profit Organizations* - this project will address whether and how to amend Section 4450, Reporting Controlled and Related Entities by Not-for-Profit Organizations, regarding how to account for controlled not-for-profit organizations and profit-oriented enterprises (Principle 10) and the disclosure of economic interests (Principle 11). This project will also address the proposals related to the presentation and disclosure of expenses (Principle 14). An Exposure Draft is expected to be developed in the second half of 2016; and
- *Contributions – Revenue Recognition and Related Matters* - this project will entail further research on the recognition of revenue from contributions (Principles 1 to 4) and will address the implications of eliminating the size exemption for capital assets (Principle 7) and financial statement presentation (Principle 13).

A summary of all current active projects can be found at: <http://www.frascanada.ca/standards-for-not-for-profit-organizations/projects/active/item56204.aspx>.

CPA Canada Handbook – Accounting, Part I: International Financial Reporting Standards

International Financial Reporting Standards (IFRS) are required for publicly accountable enterprises (PAE) and government business enterprises (GBE) and are optional for private enterprises and private not-for-profit organizations. A PAE is defined as an entity, other than a not-for-profit organization or a government or other entity in the public sector, that has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market, or holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. First-time adoption of the Handbook – Accounting Part I by publicly accountable enterprises was mandatory for interim and annual financial statements relating to annual periods beginning on or after January 1, 2011. Investment companies and segregated accounts of life insurance enterprises are required to adopt IFRS for periods beginning on or after January 1, 2014. Entities with rate-regulated activities are required to

adopt IFRS for periods beginning on or after January 1, 2015. While it is anticipated that most existing entities have already adopted IFRS within the required timeline, practitioners are reminded that any entity adopting this framework for the first time should be guided by the accounting and disclosure requirements of the Handbook – Accounting Part I; IFRS 1, First-Time Adoption. In particular, paragraph .06 states that “An entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. This is the starting point for its accounting in accordance with IFRSs.” An entity that prepares its financial statements in accordance with Part I must disclose that the financial statements have been prepared in accordance with international financial reporting standards.

The common deficiencies in the 2014 – 2015 practice review cycle related to IFRS were:

- Lack of disclosure of the domicile of the entity, and the address of its registered office or principal place of business (IAS 1.138);
- Lack of disclosure of date of authorization of the financial statements and who gave that authorization (IAS 10.17);
- Lack of disclosure of the objectives, policies and processes for managing capital and of the items comprising managed capital (IAS 1.134 and 1.135);
- Lack of disclosure of the relationship between tax expense (income) and accounting profit (IAS 12.81);
- Lack of disclosure regarding concentrations of risk, objectives, policies and procedures for managing risk, methods for measuring risk, and quantitative data about the exposure to risk. (IFRS 7.31 -.34);
- Lack of disclosure regarding the level in the fair value hierarchy into which the fair value measurements are categorized (IFRS 13.91);
- Lack of disclosure of key management personnel compensation (IAS 24.17); and
- Lack of disclosure of the amounts for dividends per share in either the statement of changes in equity or in the notes to the financial statements (IAS 1.107).

Current Projects

There are several Exposure Drafts available for comment, which can be found at: <http://www.frascanada.ca/international-financial-reporting-standards/documents-for-comment/open-for-comment/item55921.aspx>.

A summary of all current active projects can be found at: <http://www.frascanada.ca/international-financial-reporting-standards/projects/active/item55217.aspx>.

Public Sector Accounting Standards

The Public Sector Accounting Board (PSAB) establishes generally accepted accounting principles for governments and governmental organizations, including government not-for-profit organizations. The standards issued by PSAB can be found in the Handbook – Public Sector Accounting. The decision tree in Appendix A of the Introduction to Public Sector Accounting Standards in the Handbook – Public Sector Accounting will help organizations determine which basis of accounting they should follow. Consideration must be given to the definitions of control, government business enterprises and government not-for-profit organizations when applying the decision tree. These definitions can be found in the Introduction to Public Sector Accounting Standards and PS 1300. The following summarizes the accounting standards that are applicable for various public sector entities:

- Governments follow Public Sector Accounting Standards;
- Government not-for-profit organizations have a choice of following Public Sector Accounting Standards with or without the not-for-profit standards (4200 series) within the Public Sector Handbook;
- Government Business Enterprises follow IFRS; and
- Other Government Organizations have a choice of following Public Sector Accounting Standards or IFRS.

Practitioners are reminded of the numerous standards that were issued in March 2012. These standards are:

- PS 3450, Financial Instrument;
- PS 2601, Foreign Currency Translation;
- PS 1201, Financial Statement Presentation; and
- PS 3041, Portfolio Investments.

The effective date is for years beginning on or after April 1, 2019, with early adoption encouraged. The effective date was for fiscal years beginning on or after April 1, 2012 for government organizations that applied the Handbook – Accounting prior to their adoption of the Public Sector Accounting Handbook. These standards must be adopted at the same time.

The common deficiencies in the 2014 – 2015 practice review cycle related to Public Sector Accounting Standards were:

- Lack of acknowledgement of government’s responsibility for financial statement preparation (PS 1200.005);
- Incomplete disclosures related to any surplus or deficit in multi-employer retirement benefit plans (PS 3250.111); and
- Presentation of the statement of changes in net debt did not include a comparison with budget (PS 1200.123).

Current Projects

In April 2013, the AcSB in conjunction with the PSAB issued a SOP. This SOP, titled Improvements to Not-for-Profit Standards, is applicable for both private not-for-profit organizations applying the Handbook – Accounting Part III and government not-for-profits choosing to follow PS 4200. Private not-for-profits applying the Handbook – Accounting Part I (International Financial Reporting Standards) and government not-for profits applying the Handbook – Public Sector Accounting without the PS 4200 series are not affected by this SOP. The effects of the proposals on the different sectors of not-for-profit entities are significant and are summarized below:

Effects of proposals affecting both private and public sector not-for-profits:

- Replacement of the deferral and restricted fund methods of accounting for contributions; and
- Removal of the size exemption to record capital assets – all not-for-profits required to record and amortize capital assets.

Effects of proposals primarily affecting government not-for-profits:

- Requirement to present the “net debt” indicator, statements of change in net debt and re-measurement gains/losses and budget information and
- Intangible assets, works of art and historical treasures to be accounted for using PS 4230 even though inconsistent with PS 1000.

Effects of proposals primarily affecting private sector not-for-profits:

- Controlled not-for-profits required to be consolidated, except in specific circumstances;
- Expenses required to be presented by both function and object (nature);
- Collections of works of art and historical treasures to be accounted for at cost or nominal value; and
- Required to follow CPA Handbook – Accounting Part II (Accounting Standards for Private Enterprises) for accounting of tangible capital assets, including Section 4431 of CPA Handbook – Accounting Part III.

The SOP is now closed for comment and the AcSB approved the following projects to address all of the Principles from the 2013 SOP:

- Accounting Standards Improvements: the AcSB decided to conduct an accounting standards improvements project in two phases. The first phase will address whether and how to amend the standards regarding the accounting for capital assets other than the size exemption, but including collections of works of arts and historical treasures and the disclosure of related party transactions and allocated expenses (Principles 5, 6, 8, 9, 12 and 15). The second phase of the project will address whether and how to amend Section 4450, Reporting Controlled and Related Entities by Not-for-Profit Organizations, regarding how to account for controlled not-for-profit organizations and profit-oriented enterprises (Principles 10 and 11).

This phase of the project would also address the proposals related to the presentation and disclosure of expenses (Principle 14).

- Contributions – Revenue Recognition and Related Matters: the AcSB approved a project to conduct further research on the recognition of revenue from contributions (Principles 1 to 4). This project will also address the implications of the deliberations relating to the size exemption for capital assets (Principle 7) and financial statement presentation (Principle 13). Information and updates regarding this Joint Not-for-Profit Review can be found on the Financial Reporting and Assurance Standards Canada website at:
<http://www.frascanada.ca/standards-for-not-for-profit-organizations/projects/active/item56097.aspx>.

A summary of all current active projects can be found at: <http://www.frascanada.ca/standards-for-public-sector-entities/projects/active/item56215.aspx>.

REVIEW ENGAGEMENTS

The CPA Canada Assurance and Related Services Guideline AuG-20, *Performance of a Review of Financial Statements in Accordance with Sections 8100 and 8200*, provides specific guidance and direction with respect to various aspects of review engagement documentation.

The common deficiencies in the 2014-15 practice review cycle related to the performance of review engagements were:

Inquiry, Analytical Procedures and Discussion to Establish Plausibility

While checklists are a good tool for performing a review engagement, the completion of only a checklist without additional comments is not considered to be sufficient documentation of the public accountant's inquiries, analytical procedures and discussions. Documentation of inquiries, analytical procedures and discussions may be included in either the working papers (e.g. memos) that are cross referenced back to the checklist or the comments column of the checklist itself. Documentation of discussions with clients should also include the name of the individual(s) with whom the matters were discussed and the date of the discussions.

Of particular concern are the following issues:

- *Inter-relationship/comparison of revenues, expenses, gross margin, operating ratios and balance sheet items* - the practitioner should focus on significant financial statement items, or key aspects of the client's business. Even if there are no unusual amounts, variances or trends, an assessment of the plausibility of significant items should be included to evidence that the practitioner gave such items due consideration;

- *Cut-off procedures – cash, sales, purchases/inventory and accounts payable* - typically, documentation should include a description of procedures followed by the client to ensure proper cut-off, a conclusion on their adequacy and, if deemed necessary, details of any additional review procedures required to assess plausibility of the related balances;
- *Inventory – client’s count procedures and valuation* - typically, documentation should include a description of the client’s inventory count procedures, including the date of the inventory count, count instructions, use of count tags, supervision, segregation of obsolete and slow-moving inventory and inventory on consignment, to assess whether the procedures are designed to arrive at a proper and consistent count. The client’s basis of determining “cost” (FIFO, specific item, etc.) and whether that basis is consistent should be documented;
- *Contingencies, commitments and subsequent events* - typically, documentation should include matters discussed with the client, including name and title of individual to whom inquiries were made and the date thereof (which should not precede the date of the review engagement report); and
- *GST – plausibility of amounts* - consideration should be given as to whether a copy of the year-end GST return is sufficient documentation to support the plausibility of the amounts paid/received during the year and the year-end balance.

Engagement and Representation Letters Omitting Required Inclusions

As with audit engagements, most review engagement files included these documents, but in some instances certain required matters were omitted. The requirements are set out in CPA Canada Handbook – Assurance, Other Canadian Standards, Section 8200.

Current Projects

In May 2015, the Auditing and Assurance Standards Board (AASB) issued a re-exposure draft that proposes a new standard dealing with engagements to review historical financial statements to replace existing review engagement standards. The AASB is currently deliberating the comments received on the re-exposure draft and final material is expected to be approved before the end of the year. The proposed standard will be effective for reviews of historical financial statements for periods ending on or after December 14, 2017, with earlier application not permitted.

The re-exposure draft can be found on the Financial Reporting and Assurance Standards Canada website at <http://www.frascanada.ca/assurance-and-related-services-standards/documents-for-comment/item81400.pdf>.

COMPILATION ENGAGEMENTS

Section 9200 of the *Handbook – Assurance* establishes the standards for compilation engagements.

The common deficiencies in the 2014-15 practice review cycle related to the performance of compilation engagements were:

- There were numerous instances in which the compilation file did not include evidence that the practitioner had considered his or her independence. Although the performance of a compilation engagement does not require that the accountant be independent, any activity, interest or relationship that may impair the accountant’s independence should be disclosed in a separate paragraph in the Notice to Reader;
- The notes to the financial statements included a reference to generally accepted accounting principles;
- An engagement letter was not obtained or was outdated. The file should document that the public accountant has reached an understanding and agreement with the client regarding the services to be provided;
- Signing report issues:
 - The designation was abbreviated, i.e., “CA” rather than “Chartered Accountant” or an abbreviation of one of the other legacy designations; and
 - The firm was not signing the report in the name approved by CPA Alberta Registrations.

Current Projects

The Auditing and Assurance Standards Board has determined that there may be a need for a clarified standard that provides requirements and guidance on specific matters that have caused confusion and ambiguity in performing compilation engagements. A task force has been formed for this project whose duties include determining the nature and extent of revisions that should be made to Section 9200, *Compilation Engagements* and may involve adoption of International Standard on Related Services (ISRS) 4400, *Compilation Engagements*.

Refer to <http://www.frascanada.ca/assurance-and-related-services-standards/projects/active/item55562.aspx> for updates on this project.

AUDIT ENGAGEMENTS

The Canadian Auditing Standards (CAS) applies to all audits of financial statements and was effective for all fiscal years ended on or after December 14, 2010.

The common deficiencies in the 2014-15 practice review cycle related to the performance of audit engagements were:

Documentation of the Auditor's Assessment of Risks of Material Misstatement at the Financial Statement Level and Assertion Level

The assessment of the risk of material misstatement should be conducted at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures. The assessment of risk at the financial statement level is affected by the auditor's understanding of the control environment.

In assessing the risks of material misstatement, the auditor documents whether any of the risks identified were considered to be significant or not. The risk of management override of controls is present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk (CAS 240, paragraph 31).

Inherent risk is assessed for assertions before any consideration of controls that may address the risk; consequently, in many instances, it would be expected that the assessed level of inherent risk would be other than low (CAS 330, paragraph 8(a)). Consideration should be given to whether the assessment of risks of material misstatement at the assertion level includes an expectation that relevant controls are operating effectively. In such circumstances, the auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of such controls.

The auditor should develop an audit plan that addresses the assessment of the risk of material misstatement. In addressing risks at the financial statement level, the auditor determines overall responses such as staffing and timing of audit procedures. To address risks at the assertion level, the audit plan should provide a **clear linkage** between the risk assessment and the nature, timing and extent of audit procedures.

Documentation of the Auditor's Understanding of the Entity And Its Environment

CAS 315 sets out a number of areas which the auditor should consider in obtaining and documenting an understanding of the entity and its environment. While improvements have been noted in many of these areas, documentation deficiencies are still noted with respect to:

- The control environment;
- The entity's risk assessment process;
- Information systems, including related business processes, relevant to financial reporting and communication;
- Financial reporting processes used to prepare financial statements;
- Entity's response to risks arising from information technology;
- Industry, regulatory and other factors; and
- Compliance with laws and regulations.

Documentation of Fraud Risk Factors

Fraud risk factors were not always documented in the assessment of the risks of material misstatement within audit planning.

As discussed in CAS 240, paragraph 26, the auditor ordinarily presumes the existence of fraud risk in revenue recognition and considers which types of revenue, revenue transactions or assertions may give rise to such risks. In circumstances where the auditor concludes such a presumption is not applicable, the reasons for such conclusion should be documented (CAS 240, paragraph 47).

Additional procedures that should be documented as part of the auditor's fraud risk assessment include:

- Discussions with management regarding their assessment of fraud risks and how they address them, relevant communications with respect to fraud, and whether they are aware of any actual, suspected or alleged fraud. Documentation in the file should include the name of the management representative(s) with whom the inquiries were made and the results of the auditor's inquiries (CAS 240, paragraphs 17-18; CAS 315, paragraph 6);
- Discussions with those charged with governance regarding how they exercise oversight over management's processes with respect to fraud and whether they are aware of any actual, suspected or alleged fraud. This should be taking place during the planning phase of the audit, as the results of these discussions should be incorporated into the audit plan (CAS 240, paragraphs 20-21; CAS 315, paragraph 6); and
- Engagement team meeting to discuss how and where the entity's financial statements may be susceptible to material misstatement due to fraud or error. This should include the list of attendees, the results of those discussions and provide a clear linkage to the auditor's response to the identified risks (CAS 240, paragraph 15; CAS 315, paragraph 10).

Materiality

The determination of materiality should consider the financial information needs of users of the financial statements. In addition to calculating an overall materiality, CAS 320 also requires the determination of performance materiality for all audits and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures.

Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements as a whole to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole (CAS 320, paragraph A12).

Practitioners are also reminded that CAS 450.10 requires that materiality be reassessed at the end of the engagement to confirm whether it remains appropriate in the context of the entity's actual financial results.

Use of Analytical Procedures in Risk Assessment Process

The auditor should use preliminary analytical procedures as part of the risk assessment process in obtaining an understanding of the entity and its environment (CAS 315, paragraph 6). Audit procedures should be designed to address the impact of any risks identified through preliminary analytical procedures. File documentation should show a clear linkage between the planned audit procedures and identified risks. Importantly, analytical procedures should be performed with respect to revenue, and consideration should be given to unusual or unexpected relationships that may indicate risks of material misstatement due to fraud (CAS 240).

Design and Implementation of Internal Controls

In addition to obtaining an understanding of internal controls, the auditor needs to determine whether the internal controls relevant to the audit are appropriately designed and have been implemented by performing procedures in addition to inquiry of the entity's personnel (CAS 315, paragraphs 12-13). Even in audits that are purely substantive, an understanding of the design and effectiveness of internal controls is still required as part of the risk-based procedures.

If the auditor intends to rely upon any of the entity's internal controls, the auditor should refer to CAS 330.

Documentation of Substantive Audit Procedures

If audit work is not documented, there is no basis on which to conclude that the work has been performed. Auditing standards require sufficient documentation so that another professional can understand the nature, timing and extent of the work performed, results obtained and the basis for the conclusions reached (CAS 230, paragraph 8).

Areas in which the documentation of substantive audit procedures performed were found to be weak included:

- the testing of journal entries for management override;
- subsequent events review up to the date of the audit report;
- litigation and claims;
- related parties;
- search for unrecorded liabilities;
- revenues;
- expenses; and
- payroll

(CAS 230, CAS 500, CAS 501, AuG-46).

Other areas of audit documentation where improvements are required include the documentation of substantive analytical procedures (CAS 520) and audit sampling (CAS 530).

The design and performance of substantive analytical procedures requires (CAS 520, paragraph 5):

- The determination of the suitability of a particular procedure for given assertions;
- An evaluation of the reliability of the data used to develop the expectation of the recorded amounts;
- The development of an expectation of the recorded amounts before the analysis is carried out; and
- Obtaining an explanation of any difference (other than predetermined acceptable differences) between the expectation and the recorded amount and collaborating that explanation.

The requirements for audit sampling used as part of substantive audit procedures should include (CAS 530):

- Documentation of the purpose for the procedure and characteristics of the population being sampled;
- Documentation to support the sample size;
- Documentation of the sample selection procedures, which should ensure that each item in the population has a chance of selection; and
- An evaluation of the sample test results and extrapolation of any errors to the population as a whole.

Auditor's Report – Format, Date

Care should be taken to ensure that the format and content of the auditor's report is in compliance with CAS 700.

Documentation in the file needs to support the date of the auditor's report. In particular, there should be documentation that the auditor has obtained sufficient appropriate audit evidence, including that the financial statements (with the related notes) have been prepared and that those with the recognized authority have asserted they have taken responsibility for those financial statements (CAS 700, paragraph 41).

Further, the auditor should ensure that the subsequent events procedures have been performed up to the date of the report (CAS 560; AuG-46). The management representation letter should be dated as near as practical to, but not after, the date of the report (CAS 580, paragraph 14).

Communication with Those Charged with Governance

CAS 260 requires documentation of matters communicated to those charged with governance, including:

- The auditor's responsibilities in relation to the financial statement audit (consider providing a copy of the engagement letter to those charged with governance);
- An overview of the planned scope and timing of the audit;
- The written representations that the auditor is requesting from management (consider providing a copy of the letter of representation to those charged with governance);
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- The risk and existence of fraud; and
- Other matters arising from the audit that are significant to the oversight of the financial reporting process.

In addition, as set out in CAS 450, paragraphs 12 and 13, the auditor's communication to those charged with governance should include uncorrected misstatements and the effect they may have, individually or in the aggregate, on the auditor's report (unless prohibited by law or regulation), and the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

Engagement and Representation Letters Omitting Required Inclusions

Most audit files included letters of engagement (CAS 210) and representation from management (CAS 240, 250, 450, 501, 540, 550, and 580); however, there were instances where they did not cover all required matters. The most notable areas requiring improvement include:

- Obtaining a signed engagement letter prior to the commencement of the engagement; and
- Obtaining a signed management representation letter up to the date of the engagement report.

Current Projects

The AASB has numerous active projects, including the following:

- *Auditor Reporting* - users of audited financial statements are asking auditors to provide more information in their reports about significant matters in the financial statements, as

well as the conduct of the audit. In September 2013, the AASB issued an Exposure Draft, *Reporting on Audited Financial Statements*, which was based on proposals made by the IAASB. The AASB has decided to adopt international standards for auditor reporting in 2017 and has outlined a roll-out plan in a recent Invitation to Comment which seeks input on its tentative decision to set effective dates different from the IAASB. The AASB expects to issue final reporting standards in the first half of 2016. The effective date is for financial statements for periods ending on or after December 15, 2017. There will also be a staggered implementation that provides a one-year delay for the expanded reporting for audits of many listed entities.

- *Financial Statement Disclosures* - financial statement disclosures have become more detailed and complex as a result of evolving financial reporting standards. In June 2014, the AASB issued an Exposure Draft, *Addressing Disclosures in the Audit of Financial Statements*, which reflects proposals made by the IAASB. The AASB is expected to approve final Handbook material before the end of the year.

For more information on active projects, refer to <http://www.frascanada.ca/canadian-auditing-standards/projects/active/item56134.aspx>.

QUALITY CONTROL POLICIES AND PROCEDURES

The common deficiencies in the 2014-15 practice review cycle related to the performance of assurance engagements were:

Monitoring Process

An ongoing area of concern with respect to the implementation of quality control policies and procedures relates to the monitoring process. The monitoring process shall include:

- An annual consideration and evaluation of the firm's system of quality control; and
- On a cyclical basis, inspection of at least one completed assurance engagement for each engagement partner (CSQC 1, paragraph 48).

Monitoring is still not being done in many offices or, if it has been done, documentation of the monitoring and the communication of the results to engagement partners and other appropriate individuals within the firm have not been retained. Practitioners are reminded that the cyclical evaluation of completed assurance files cannot be completed by an individual who has performed work on that engagement, including the engagement quality control reviewer (EQCR). Practitioners are also reminded that the practice reviews conducted by CPA Alberta are **not** a substitute for the requirement that a firm conduct its own cyclical reviews of completed assurance engagements.

Updates to Quality Assurance Manual to comply with CSQC-1

In accordance with CSQC-1, an entity's system of quality controls were required to be established by December 15, 2009. Many practitioners still have not updated their Quality Assurance Manual to reflect changes required under CSQC-1.

Appendix A: List of Resources

COMPILATION ENGAGEMENTS

CPA Canada Handbook – Assurance, Other Canadian Standards

CPA Alberta Professional Development:

- Compilation Engagements

REVIEW ENGAGEMENTS

CPA Canada Handbook – Assurance, Other Canadian Standards

Assurance and Related Services Guideline *AuG-20, Performance of a Review of Financial Statements in Accordance with Sections 8100 and 8200* - provides specific guidance and direction with respect to various aspects of review engagement documentation.

Assurance and Related Services Guideline *AuG-47, Dating the Review Engagement Report on Financial Statements*

CPA Canada website:

- Guide – Reporting Implications of New Auditing and Accounting Standards (12th edition), April 2014 release.
<http://www.frascanada.ca/canadian-auditing-standards/resources/reference-material/item50999.pdf>

CPA Alberta Professional Development:

- Review Engagements
- Accounting, Assurance and Professional Practice Update

AUDIT ENGAGEMENTS

CPA Canada Handbook – Assurance

Financial Reporting and Assurance Standards Canada website:

- The Assurance and Related Services Standards (other than CASs) section includes Basis for Conclusions documents, reference material (articles) and archived webinars and webcasts.
<http://www.frascanada.ca/assurance-and-related-services-standards/resources/index.aspx>

CPA Canada website:

- The Business and Accounting Resources section highlights resources available, including articles, publications, webinars, implementation guidance and tools, etc. <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/canadian-auditing-standards-cas>

Some new audit resources issued in 2015 to be aware of include:

- ***Risk Assessment of Not-For-Profit Organizations (NFPOs) Under Canadian Auditing Standards (CAS)*** - get an in-depth look at performing a risk assessment under CAS, as part of an audit of a not-for-profit organization (NFPO) <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/canadian-auditing-standards-cas/publications/risk-assessment-of-nfpos-under-cas>
- ***Implementation Tool for Auditors: Testing Journal Entries & Responding to the Risk of Management Override of Controls*** - learn how to test the appropriateness of journal entries made in the preparation of financial statements as a response to the risks of management override of controls <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/canadian-auditing-standards-cas/publications/journal-entry-testing-management-override-fraud>
- ***Audit & Assurance Alert: Audit of a Candidate in a Federal Election*** - obtain practical, non-authoritative guidance on preparing the audit of a federal election candidate <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/canadian-auditing-standards-cas/publications/alert-auditing-a-federal-election-candidate>

CPA Alberta Professional Development:

- Accounting, Assurance and Professional Practice Update
- The Audit of Small Entity
- Effective Use of Analytical Procedures
- CAS Communication Requirements for Private and Non-for-Profit Audits
- File Review Methodologies
- Fraud Happens – What to do When You Suspect Fraud
- Risk Assessment Workshop Small & Medium Sized Businesses

QUALITY CONTROL POLICIES AND PROCEDURES

CPA Canada Handbook – Assurance

Quality Assurance Manual (QAM) (can be purchased at CPA store)

CPA Canada websites:

- Webinars
 - 2013 QAM Update and How to Apply Quality Control Standards in a Cost-effective Way
<https://cpacanada.ca/en/career-and-professional-development/professional-development/webinars/2013/May/2013-qam-update-cost-effective-quality-control>
 - Focus on Quality Assurance Manual
www.snwebcastcenter.com/event/?event_id=2951

CPA Alberta Professional Development:

- Quality Control – Maintaining and Monitoring

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

CPA Canada Handbook – Accounting, Part II

Guide to Accounting Standards for Private Enterprises (can be purchased at CPA store)

CPA Canada website:

- Chapter 45 *Financial Instruments* from the *Guide to Accounting Standards for Private Enterprises* provides detailed guidance on the application of Section 3856 *Financial Instruments* from the *CPA Handbook – Accounting*
<https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/accounting-standards-for-private-enterprises-aspe/publications/financial-instruments-chapter-45-guide-to-aspe>

CPA Alberta Professional Development:

- ASPE - Accounting Update
- ASPE – A Comparison to IFRS
- ASPE - A Survey of the Standards (e-learning)
- ASPE - Statement Presentation and Disclosure – From Standards to Words
- ASPE in the Construction Industry
- ASPE in the Real Estate Industry
- Accounting, Assurance and Professional Practice Update

ACCOUNTING STANDARDS FOR NOT-FOR-PROFIT ORGANIZATIONS (ASNFP)

CPA Canada Handbook – Accounting, Part III

Financial Reporting and Assurance Standards Canada website:

- Further changes expected as noted in the Statement of Principles:
<http://www.frascanada.ca/standards-for-not-for-profit-organizations/documents-for-comment/item73780.pdf>

CPA Canada website:

- Guide to Accounting Standards for Not-for-Profit Organizations in Canada
<https://www.cpacanada.ca/business-and-accounting-resources/Financial-and-non-financial-reporting/not-for-profit-organizations/publications/guide-to-accounting-standards-for-not-for-profit-organizations-in-canada>

CPA Alberta Professional Development:

- NFPOs – A Survey of Standards under Part III of the Handbook
- NFPOs – Financial Statement Presentation and Note Disclosure (Non-Government Controlled Not-for-Profit Organizations)
- NFPOs & Registered Charities – Accounting, Auditing and Taxation Issues
- Accounting, Assurance and Professional Practice Update.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

CPA Canada Handbook – Accounting, Part I

CPA Canada website – includes the following resources:

- The IFRS section of the website contains comprehensive information and learning resources on the transition and application of IFRS, such as articles, webinars and publications that provide guidance on applying new and existing standards, sample illustrative financial statements, sector specific illustrative financial statements and disclosure checklists and numerous industry specific and topic specific IFRS courses which can be accessed at:
<https://cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/international-financial-reporting-standards-ifs>

CPA Alberta Professional Development:

- IFRS Update – 2015
- IFRS: A Survey of the Standards (online)
- IFRS: Financial Statement Presentation & Note Disclosure
- IFRS: Oil & Gas Industry

PUBLIC SECTOR ACCOUNTING

CPA Canada Public Sector Accounting Handbook

Financial Reporting and Assurance Standards Canada website – the Standards for Public Entities section of the website includes Basis for Conclusion documents, reference materials (adopting public sector accounting standards, articles, non-authoritative guidance, summary comparisons and other publications) and webinars. Of particular interest are:

- Public Sector Frequently Asked Questions: Accounting Standards for Government Not-for-profit Organizations (GNFPOs)
<http://www.frascanada.ca/standards-for-public-sector-entities/projects/completed/item45107.pdf>
- PSAB Matters Articles – “*When loans are really grants*” and “*Valuing portfolio investments*”
<http://www.frascanada.ca/standards-for-public-sector-entities/resources/reference-materials/index.aspx>

CPA Canada website – includes the following resources:

- Guide for Accounting Standards for Not-for-profit Organizations in Canada (including GNPO)
<https://www.cpacanada.ca/business-and-accounting-resources/Financial-and-non-financial-reporting/not-for-profit-organizations/publications/guide-to-accounting-standards-for-not-for-profit-organizations-in-canada>

CPA Alberta Professional Development:

- PSAB 101

Appendix B - Practice Aids

CANADIAN PROFESSIONAL ENGAGEMENT MANUAL (C•PEM)

The C•PEM is designed to assist practitioners in performing assurance and compilation engagements for small- and medium-sized entities and to promote consistent application of the Canadian Audit Standards (CASs) and Other Canadian Standards (OCSs) included in the *CPA Canada Handbook – Assurance*. Practitioners should be aware that the C•PEM provides non-authoritative guidance and is not a substitute for professional standards and the related pronouncements. It is also not a substitute for the practitioner’s professional judgement.

The 2015 edition of the C•PEM was released in early September 2015. The Knotia on-line version is the official version and will be updated in real-time whenever changes to the publication are required. Updates to other versions of the C•PEM continue as before: the print version will be updated and issued on an annual basis; the Virtual Professional Library DVD and Download versions will be updated as changes become available.

Changes in the 2015 Edition

Few changes have been made in the 2015 edition as the profession works on a new publication for 2016 and beyond. Changes include wording revisions to reflect changes to the C•PEM audit forms and updated sample completed forms and structured memos. Details of the changes are outlined in the publication.

To assist members in properly completing the forms, there are now approximately 30 five to ten minute video presentations that cover the key C•PEM forms.

The C•PEM and related publications can be purchased online at the CPA store at <http://www.cstore.ca/Catalogue/Catalogue.aspx?categoryID=9>

PUBLIC PRACTICE MANUAL (PPM)

The PPM is designed to assist practitioners providing professional services. Material in the manual can be classified into three categories:

- Recommended standards of practice — descriptions and interpretations of authoritative professional standards;
- Advice — examples of required procedures and documentation; and
- Information — practical, but not authoritative content.

Examples of recommended standards of practice published in the manual include the auditing guidelines, the related services guidelines, and the management consulting services guidelines. Advice can be found in the sample checklists, forms and letters, and financial statements.

The *CPA Canada Public Practice Manual* (previously *CGA Canada Public Practice Manual*) is available online, on CD, and in print. The 2015-16 edition was released in May 2015. Full updates are done to the PPM semi-annually. On-going updates are communicated to subscribers as they occur.

The PPM can be purchased on-line at <https://buyppm.cga-canada.org/Home.aspx>.

PROFESSIONAL ENGAGEMENT GUIDE (PEG)

The PEG will be replacing the C•PEM and PPM for 2016 and beyond. The PEG will include a number of changes to Volumes 1 and 2 of the C•PEM as well as new materials from the PPM. In developing the PEG, the profession formed a PEG Advisory committee which included those members in public practice who would be users of the new product. This committee has reviewed both the C•PEM and PPM to identify the best of both publications and has provided input into the form and content of the PEG. The first release of the PEG is targeted for August 2016.