Focus On Practice Review Reportable Deficiencies 2016

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Note: This document is published on an annual basis to assist public practitioners and others in fulfilling their professional duties. Any enquiries on this publication can be directed to Erin Wallish, CPA, CA, Director of Practice Review, at ewallish@cpaalberta.ca. General questions on other issues related to professional services should be directed to Larry Brownoff, CPA, CA, Director, Professional & Career Services at lbrownoff@cpaalberta.ca.

BACKGROUND

The objective of the CPA profession's practice review program 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 CPA profession across Canada has adopted a harmonized evaluation methodology. This methodology provides for a consistent approach to practice review in all provinces and the use of consistent terminology throughout. Harmonization also 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 practice review as either reportable deficiencies (reportable to that province's Practice Review Committee) or non-reportable matters (items brought only to the attention of the reviewed office and not to the Committee). The office is strongly encouraged to respond to the Practice Review Committee by stating how it will address the reportable deficiencies identified by the practice reviewer. The Practice Review Committee will then assess the reportable deficiencies and the office's response to determine if any further action is required.

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 2016 inspection cycle. The publication 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 appendix lists helpful resources and tools that can be used to obtain an understanding of and comply with the various requirements.

COMPILATION ENGAGEMENTS

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

It was found that while compilations generally had fewer deficiencies than in other areas, the following matters arose most often and should be considered by practitioners when completing these types of engagements.

- ***Assessment of independence.*** 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.

- ***Reference to accounting framework.*** The notes to the financial statements included a reference to generally accepted accounting principles and/or one of the financial reporting frameworks contained within the CPA Canada - Accounting Handbook. Section 9200 does not require compilation engagements to be performed in accordance with generally accepted accounting principles or one of the financial reporting frameworks contained within the CPA Canada – Accounting Handbook. Note disclosure indicating the financial statements are in accordance with such a framework is misleading if the practitioner has not done enough work to determine whether the note disclosures are in fact in accordance with such a framework. Note disclosure indicating that financial statement note disclosures are not in accordance with such a framework is also misleading as it implies presentation and measurement are in accordance with such a framework. Therefore, this disclosure should not be included.

- ***Engagement letter missing or outdated.*** 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.

Current Projects

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

An exposure draft is being developed and is expected to be approved in the second half of 2017.

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

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 2016 practice review cycle related to the performance of review engagements were:

- ***Inquiry, analytical procedures and discussion to establish plausibility***
  The lack of adequate documentation of the inquiry, analytical procedures and discussion to establish plausibility remains the number one deficiency for review engagements.

  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. Unless there is documentation that no unusual amounts, variances, or trends are expected, 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 would 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 would 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 also be documented.

- ***Contingencies, commitments and subsequent events*.** Typically, documentation would include matters discussed with the client, including name and title of individual to whom inquiries were made and the date thereof (which should either be on or before the date of the review engagement report).

- ***Engagement and representation letters omitting required inclusions.*** 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*.

- ***Written representation from management not effective as of date of Review Engagement Report***

- ***No documentation to support the Review Engagement Report date.***

- ***Plausibility of opening balances on transition from a notice to reader engagement to a review engagement.*** The practitioner should give careful consideration to the plausibility of the opening balance sheet accounts and the possibility of an opening cut-off error when adopting a financial reporting framework for the first time. Items such as (but not limited to) allowance for doubtful accounts, inventory valuation, existence of capital assets, and completeness of accounts payable are not normally considered in a compilation engagement. As well, practitioners should be aware of the recommendations of Part II 1500 and Part III 1501 regarding first-time adoption of Accounting Standards for Private Enterprises and Accounting Standards for Not-for-Profit Organizations.

- ***Inappropriate accounting treatment of identified cut-off errors**.* Upon discovery of a non-trivial opening cut-off error, the practitioner should evaluate the effect on the reviewed financial statements of the prior year and determine the appropriate course of action, with reference to Part II 1506 Accounting Changes (specifically Errors). It is inappropriate to adjust the error through the current year's income statement without first evaluating the effect on the plausibility of the current year's and prior year's financial statements.

Current Projects

In December 2015, the AASB approved CSRE 2400, *Engagements to Review Historical Financial Statements*. The AASB concluded that changes made in finalizing the CSRE were not significantly different from the proposals in the Re-exposure Draft and, therefore, no re-exposure was necessary. The revisions will be effective for reviews of financial statements for periods ending on or after December 14, 2017 and were reflected in an April 2016 Handbook update. Early adoption of CSRE 2400 will not be permitted.

AUDIT ENGAGEMENTS

An overriding deficiency related to the performance of audit engagements continues to be with respect to documentation of planning decisions and the substantive work done to support the audit opinion. 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).

More specifically, the common deficiencies in the 2016 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. Documentation deficiencies continue to be 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.
- Control activities relevant to the audit.
- Evaluation of the design effectiveness of controls relevant to the audit and determination of whether they have been implemented 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.
- Major activities used to monitor internal control over financial reporting, including how the entity initiates remedial actions with respect to deficiencies in its controls.
- Financial reporting processes used to prepare financial statements.
- Entity's response to risks arising from information technology.
- Objectives, strategies and business risks.

- ***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).
  - 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. While overall materiality was generally calculated and supported, the other materiality levels were not.

  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).

- ***Documentation of substantive audit procedures***
  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 auditor's 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.
- The acquisition of an explanation of any difference (other than predetermined acceptable differences) between the expectation and the recorded amount and corroboration of 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.
- An evaluation of the sample test results and extrapolation of any errors to the population as a whole.

Generally, practice review found that there was insufficient rigour in the analytics being used to warrant reliance when substantive analytics were intended to be primary audit evidence (i.e., without also performing tests of details or tests of controls). In many instances, a fluctuation analysis (comparison of prior year to current year results) was used as a substantive analytical procedure without consideration of the requirements of CAS 520 noted above.

- ***Documentation of audit procedures on opening balances for a first-time audit***
  In circumstances where an organization's financial statements had been previously reviewed, the practitioner should document whether audit evidence can be obtained for the opening balance sheet accounts or whether a scope limitation exists with respect to a possible opening cut-off error which would affect the current year's statement of income (operations) and opening retained earnings (net assets).

- ***Inappropriate accounting treatment of identified cut-off errors***
  Upon discovery of a non-trivial opening cut-off error, the practitioner should evaluate the effect on the audited financial statements of the prior year and determine the appropriate course of action, with reference to Part II 1506 Accounting Changes (specifically Errors). It is inappropriate to adjust the error through the current year's income statement without first evaluating the possibility of material misstatement in the current and prior year's financial statements.

- ***Date of auditor's report***
  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. Documentation regarding who had taken

responsibility for the financial statements was often lacking; the existence of signatures on a balance sheet without the date it was signed is incomplete evidence to support the date of the auditor's report (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 practicable to, but not after, the date of the report (CAS 580, paragraph 14). Documentation of subsequent event procedures up to the required date was often lacking and management representation letters were often dated well before or well after the report date.

- ***Communication with those charged with governance***
  There were many instances where the engagement file did not include documentation to support that the requirements of CAS 260 (Communication with Those Charged with Governance), were met.

  The requirements for communication with those charged with governance are intended to be scalable. For example, when auditing smaller entities, the auditor may communicate in a less structured manner than when auditing listed or larger entities. Generally, oral communication is adequate, particularly when there is ongoing contact and dialogue with those charged with governance. Auditors need to communicate significant findings from the audit in writing only if, in their professional judgement, oral communication would not be adequate. Oral communication may not be adequate, for example, when a matter is complex or controversial or has legal implications.

  Where required matters are communicated orally, the auditor must include them in the audit documentation, specifying when and to whom they were communicated. Where matters have been communicated in writing, the auditor must retain a copy of the communication as part of the audit documentation.

- ***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.

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 discussed different approaches for reflecting the new auditor reporting standards in the Handbook, including during the transition period prior to their effective date. In November of 2016 the AASB issued a Message from the Chair with an update on the project. Highlights from the update include the expectation that key audit matter reporting will first be required for audits of entities listed on the TSX, with the AASB still considering the requirement for other listed entities. The AASB noted that they expect the U.S. standard setting process to be complete in early 2017, which would allow them to determine the impact of the U.S. standards and approve the CASs for auditor reporting and other standards in the second quarter of 2017. The AASB does not anticipate making the CASs effective prior to periods ending on or after December 15, 2018.

- ***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 has approved the final Handbook material and it is expected to be issued in in the second quarter of 2017.

- ***Auditing Accounting Estimates****.* Accounting estimates and related disclosures have become more complex. Stakeholders have indicated that clearer or additional guidance is needed to enable auditors to appropriately deal with these complexities. The IAASB is proposing revisions to ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures.* An exposure draft is being prepared with approval expected in the April 2017.

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

QUALITY CONTROL POLICIES AND PROCEDURES

CSQC 1 of the CPA Canada Handbook – Assurance establishes quality control standards for firms that perform audits and reviews of financial statements, and other assurance engagements.

The common deficiencies in the 2016 practice review cycle related to the performance of assurance engagements were:

- ***Monitoring Process***
  Improvement has been noted in the documentation and implementation of the requirements of the CSQC 1 standards; however, there were still issues noted with respect to the cyclical monitoring of completed assurance files. This included the suitability of the monitor performing the cyclical inspection (e.g., the monitor's qualifications; for internal monitoring, whether they had the appropriate authority), the quality of the monitoring (e.g., appropriateness of the files selected for monitoring, the depth and rigor of the monitoring process and its scope), and the documentation of the monitoring. In many instances, the practitioner was unaware of the cyclical monitoring requirement or did not believe that it was applicable to his or her practice.

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 the provincial bodies are **not** a substitute for the requirement that a firm conduct its own cyclical inspections 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 was required to be established by December 15, 2009. Some practitioners still have not updated their Quality Assurance Manual to reflect changes required under CSQC-1.

FINANCIAL STATEMENT PRESENTATION

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

Common deficiencies in the 2016 practice review cycle related to financial statement presentation under ASPE include the following:

- ***Financial reporting framework***. Disclosure in the notes that the financial statements are prepared in accordance with Canadian accounting standards for private enterprises was often missing (Part II, Section 1400.16).

- ***Related party transactions***. Lack of disclosure of one or more of the following items pertaining to related party transactions: terms and conditions, nature and extent of transactions, description of relationship, and the measurement basis used (Part II, Section 3840.51).

- ***Significant* accounting policies**. Lack of disclosure of the following policies:
  - Revenue recognition policy for all significant transaction streams (Part II, Section 3400.31). Also, in many instances, the revenue recognition policy was too generic to be useful to the reader.
  - Policy used to account for income taxes. An enterprise shall use the taxes payable method or the future income taxes method. In numerous instances, incorrect or outdated terminology was used to describe the accounting policy. When the income taxes payable method has been adopted, 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).
  - Accounting policies adopted in measuring inventories, including the cost formula (Part II, Section 3031.35).

- ***Issued share capital***. Lack of disclosure of the details of issued share capital. Part II, Section 3240 sets out disclosure requirements for issued share capital. The number of shares of each class together with a description and par value (if any) shall be disclosed. Disclosure of the dividend rate on preference shares together with the redemption price of redeemable shares is also required. 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.

- ***Debt due on demand***. Debt due on demand, **including related party debt with no repayment terms,** was often inappropriately classified as long-term debt. According to 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 amount of any financial liabilities that are secured, together with the carrying amount of assets pledged as security for liabilities and the terms and conditions relating to the pledge (Part II, Section 3856.43-.44).

- ***Guarantees.*** There was lack of disclosure by the guarantor, for each guarantee, or each group of similar guarantees, even when the likelihood of the guarantor having to make any payments under the guarantee is slight such as:
  - The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose and the events or circumstances that require the guarantor to perform under the guarantee;
  - The maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee;
  - The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee;
  - The nature of any recourse provisions that enable the guarantor to recover from third parties any of the amounts paid under the guarantee; and

- The nature of any assets held as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee (Part II AcG-14.9).

- ***Impaired financial assets***. Lack of disclosure of the carrying amount of impaired financial assets, by type of asset, and the amount of any related allowance for impairment (Part II, Section 3856.42).

- ***Prior period errors***. There were a number of instances where prior period errors were inappropriately referred to as prior period adjustments, were not corrected in accordance with Part II, Section 1506.27, and/or the disclosure was not in accordance with Part II, Section 1506.37.

Practitioners are reminded that the requirements for first-time adoption of ASPE must be applied to all entities reporting under these standards for the first time. This would be the case for entities that have switched from a compilation engagement to an assurance 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 many situations, disclosure was insufficient in the year of adoption.

Upcoming Changes and Current Projects

In response to stakeholder feedback, the Accounting Standards Board (AcSB) agreed to revise the timing of the annual improvements process. An exposure draft will now be issued in September each year rather than February and final amendments will be released in the *CPA Canada Handbook* the following July as opposed to October. As a result, the next cycle of annual improvements will be issued in 2017.

The AcSB has numerous active projects including:

- ***Accounting for Agricultural Assets*** – a discussion paper was issued in December 2015, webinars were held in January 2016 and the AcSB has been holding roundtable discussions across the county since May 2016. The issues to be addressed by this project include:
  - When a biological asset should be recognized
  - How it should be measured on initial recognition
  - How it should be measured in subsequent periods
  - How agricultural produce at the point of harvest should be accounted for
  - What disclosure should be required

  Based on input received from stakeholders on its discussion paper the AASB plans to develop an exposure draft of a new standard, expected to be issued for public comment in the first quarter of 2018.

- ***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. As a result of feedback received from stakeholders, the AcSB continues to research and discuss the viability of a classification exception and the conditions under which an exception might be permitted. Currently the AASB is developing a re-exposure draft, which is expected to be issued in the third quarter of 2017.

- ***Subsidiaries and Investments*** – the AcSB issued amendments to Section 1591, *Subsidiaries*, and Section 3051, *Investments*, in December of 2016. The amendments clarify the accounting for a subsidiary and an investment subject to significant influence when the cost method is used will be effective for fiscal years beginning on or after January 1, 2018, with earlier application permitted.

- ***Subsidiaries and Interests in Joint Arrangements*** – the AcSB issued narrow scope amendments to Section 1591, *Subsidiaries*, and Section 3056, *Interests in Joint Arrangements*, in December of 2016. The amendments provide clarification relating to transitional provisions, accounting for voting interest, and consideration of contractual arrangements, and will be effective for years beginning on or after January 1, 2017, with earlier application permitted.

- ***Financial Instruments -*** based on feedback received from respondents to its Post-implementation Review of Section 3856 Financial Instruments, the AcSB has undertaken a project to address several narrow-scope issues associated with the scope of related party transactions and measurement of related party compound financial instruments and disclosure. An exposure draft is expected to be approved in the third quarter of 2017.

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)

The common deficiencies in the 2016 practice review cycle with respect to financial statement presentation under ASNFPO include the following:

- ***Revenue recognition policy*** – the accounting policy was often not 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 (Part III, Section 4410).

- ***Deferred contributions –*** not-for-profit organizations using the deferral method often did not disclose the nature and amount of changes in deferred contributions for the period (Part III, Section 4410.54).

- ***Tangible capital assets –*** tangible capital assets were often not amortized over their useful lives. 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 (Part III, Section 4431).

- ***Financial reporting framework*** - disclosure in the notes that the financial statements are prepared in accordance with Canadian accounting standards for not-for-profit organizations was often missing (Part III, Section 1401.17).

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. The AcSB has undertaken the following projects in response to feedback from private sector stakeholders:

- ***Accounting Standards Improvements*** - this project addresses 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 was issued in February and is available for comment until May 31, 2017.

- ***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*, in regards to the accounting 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).

- ***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 (IFRS)

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 entities 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 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 were 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 2016 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 with respect to a sensitivity analysis of each type of market risk that an entity is exposed to (IFRS 7.40).
- 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 related to credit risk including analysis of past due financial assets not impaired, impaired financial assets, realized collateral, and the credit quality of financial assets that are neither past due nor impaired (IFRS 7.36 - .38).
- Lack of disclosure related to liquidity risk including a maturity analysis for non-derivative financial liabilities that shows the remaining contractual maturities (IFRS 7.39).
- Lack of disclosure of related party transactions (IAS 24.18).
- Lack of disclosure of key management personnel compensation (IAS 24.17).
- Lack of disclosure of the presentation currency (IAS 1.51)
- Lack of disclosure related to presentation reclassifications (IAS 1.41)

Upcoming Changes and Current Projects

In July and May 2014 respectively, the International Accounting Standards Board (IASB) issued IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. Both standards are considered major changes, taking effect for annual periods beginning on or after Jan 1, 2018, with earlier application permitted. IFRS 9 *Financial Instruments* introduces a new credit loss impairment model whereby an entity is required to book expected credit losses at the inception of a financial instrument. IFRS 15 *Revenue from Contracts with Customers* introduces a new comprehensive five-step model for revenue recognition. Key differences from existing standards include segmentation of contracts into performance obligations, measurement of revenue based on probability weighted average approach, and the concept of control as related to performance obligations and resulting revenue recognition.

In January 2016 IASB issued IFRS 16 *Leases,* effective for annual periods beginning on or after January 1, 2019, with earlier application permitted if IFRS 15 has been adopted. The new standard requires the recognition of right of use assets and lease liabilities related to all leases with the exception of leases meeting the definition of short-term and/or low value.

IFRS exposure drafts available for comment 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

CPA Canada Public Sector Accounting Handbook

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 *CPA Canada Public Sector Accounting Handbook*.

The decision tree in Appendix A of the Introduction to Public Sector Accounting Standards in the *CPA Canada Public Sector Accounting Handbook* 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 with or without the not-for-profit standards (4200 series) within the Public Sector Handbook.
- Government Business Enterprises follow IFRS.
- Other Government Organizations have a choice of following Public Sector Accounting or IFRS.

Practitioners are reminded of the numerous standards that were issued in March 2012. The effective date is for years beginning on or after April 1, 2019, with early adoption encouraged. The effective date is 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.

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

The common deficiencies in the 2016 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 multiemployer retirement benefit plans (PS 3250.111).
- Presentation of the statement of changes in net debt did not include a comparison with budget (PS 1200.123).
- Lack of disclosure of long-term debt (PS 3231.15, .17- .18, .24-.25).
- Lack of disclosure related to tax revenue including recognition (PS 3510.45).

Upcoming Changes and Current Projects

PSAB has issued five new standards effective for fiscal years beginning on or after April 1, 2017, with early adoption permitted, as follows:

- PS 2200 Related Party Disclosure – establishes disclosure requirements for related party transactions.

- PS 3420 Inter-Entity Transactions – establishes the recognition, measurement and disclosure of inter-entity transactions.
- PS 3210 Assets – offers additional guidance on the definition of asset in PS 1000 and sets out additional disclosure requirements.
- PS 3320 Contingent Assets – defines and sets out disclosure requirements on contingent assets.
- PS 3380 Contractual Rights – defines and sets out disclosure requirements on contractual rights.

PSAB is currently undergoing a project to improve revenue recognition principles and presentation requirements for governments and government organizations. Tax revenue and government transfers are outside of scope of this project. An exposure draft has been approved and is expected to be issued in the second quarter of 2017.

Exposure drafts that are available for comment can be found at:
http://www.frascanada.ca/standards-for-public-sector-entities/documents-for-comment/open-for-comment/item55550.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

Appendix A

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*

- Financial Reporting and Assurance Standards (FRAS) Canada website (www.frascanada.ca):
  - *Guide – Reporting Implications of New Auditing and Accounting Standards (12th edition), April 2014 release*

- CPA Canada website (www.cpacanada.ca):
  - *Audit and Assurance Alert: Engagements to Review Historical Financial Statements (CSRE 2400)*
  - *Audit and Assurance Alert: Comparison between CSRE 2400 and the 8000 Series*

- CPA Alberta Professional Development:
  - Review Engagements under the Current Standards
  - Review Engagements: Applying the New Standard (CSRE 2400, Engagements to Review Historical Financial Statements)
  - Review Engagement: An Overview to Plan for the New Standards (CSRE 2400, Engagements to Review Historical Financial Statements)

AUDIT ENGAGEMENTS

- *CPA Canada Handbook – Assurance, Canadian Auditing Standards (CAS)*

- FRAS Canada website (www.frascanada.ca):
  - The "Canadian Auditing Standards" tab of the website includes Basis for Conclusions documents, reference material (articles) and archived webinars and webcasts.

- CPA Canada website (www.cpacanada.ca):
  - The "Business and Accounting Resources" section highlights resources available including articles, publications, webinars, implementation guidance and tools, etc.

- Some new audit resources issued in 2016 to be aware of:
  - *Audits of Not-for-Profit Organizations: Risk Assessment under CAS*
    Guide for Auditors: Audits of Not-for-Profit Organizations: Risk Assessment under Canadian Auditing Standards addresses key issues likely to arise when applying the risk assessment standards set out in CAS in an audit of an NFPO.

  - *Audit Data Analytics Alert: Keeping Up With the Pace of Change*
    Read this audit data analytics alert to better understand audit data analytics and the drivers, opportunities and hurdles to overcome in integrating more extensive use of data analytics into the audit of financial statements.

  - *Can We Evolve Auditing Standards to Meet Significant Changes to Accounting Estimates?*
    As new accounting standards introduce radical changes to accounting estimates that will bring challenges for auditors, preparers, audit committees, prudential regulators and others accounting standard setters are moving to assist auditors with these challenges.

- CPA Alberta Professional Development:
  - Assurance and Professional Practice Update
  - Auditing Refresher
  - Identifying & Responding to Risk
  - File Review Methodologies
  - Effective Use of Analytical Procedures

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

- *CPA Canada Handbook – Accounting, Part II*

- *Guide to Accounting Standards for Private Enterprises* (can be purchased at CPAstore)

  The Guide to Accounting Standards for Private Enterprises (GASPE) helps accounting professionals apply the accounting standards that were developed specifically for private

Canadian enterprises. Updated throughout the year, this searchable, in-depth resource contains a chapter for each section of ASPE found in Part II of the CPA Canada Handbook – Accounting.

- *CPA Canada Model Financial Statements – Private Enterprises* (can be purchased at CPA store)

  This publication is presented in two sections: an analysis of the accounting standards and four sets of model financial statements with sample independent auditor reports and review engagement reports along with appropriate references to Part II of the CPA Canada Handbook – Accounting.

- CPA Alberta Professional Development:
  - ASPE and NFPO Accounting Update
  - ASPE – A Survey of the Standards
  - ASOE the Basics
  - ASPE – Disclosure & Presentation – From Standards to Words
  - ASPE – Related Party Transactions

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

- *CPA Canada Handbook – Accounting, Part III*

- *CPA Canada Model Financial Statements – Private sector NFPOs: Practical Guidance* (can be purchased at CPA store).

  The publication is designed to assist private sector not-for-profit organizations with the preparation of consistent financial statements that reflect the standards. It includes several sets of financial statements prepared in accordance with the accounting standards in Part III of the CPA Canada Handbook – Accounting for private sector not-for-profit organizations, as well as the standards in Part II that apply to NFPOs.

- CPA Alberta Professional Development:
  - ASPE & NFPO Accounting Update
  - NFPO – A Survey of the Standards Under Part III of the Handbook
  - NFPO – Disclosure & Presentation – From Standards to Words
  - NFPO & Registered Charities – Accounting, Auditing and Taxation Issues

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

- *CPA Canada Handbook – Accounting; Part I*

- FRAS Canada – IFRS Resources (www.frascanada.ca)
  - The “International Financial Reporting Standards (IFRS)” tab of the website includes reference materials on IFRS matters, such as articles and staff commentaries.

- CPA Canada website (www.cpacanada.ca)

- *Guide to International Financial Reporting Standards in Canada* (can be purchased at CPA store).

  The Guide to International Financial Reporting Standards (Canadian series) publications looks at the application of specific IFRS from a Canadian perspective. Each guide contains an overview of key requirements and practical application insights, along with a discussion of accounting policy choices, significant judgments and estimates.

- *CPA Canada Model Financial Statements – IFRS* (can be purchased at CPA store).

  Model Financial Statements — IFRS is designed to assist publicly accountable enterprises implement IFRS and comply with their financial reporting obligations. These IFRS model financial statements take into account the standards in Part I of the Handbook – Accounting for publicly accountable enterprises.

- CPA Alberta Professional Development:
  - IFRS: A Survey of the Standards
  - IFRS: An Update 2016
  - IFRS: Disclosure and Presentation – From Standards to Words
  - IFRS: Fair Value Measurements
  - IFRS: Financial Instruments
  - IFRS: Revenue Recognition
  - IFRS: Oil & Gas Industry

PUBLIC SECTOR ACCOUNTING

- *CPA Canada Public Sector Accounting Handbook*

- FRAS Canada website (www.frascanada.ca)
  - The “Standards for Public Sector Entities” tab of the website includes reference materials on public sector matters, including a table to help determine an organization’s basis of GAAP: *Determining an Organization’s Basis of GAAP*

- CPA Alberta Professional Development:
  - PSAB the Basics
  - PSAB Beyond the Basics
  - Financial Reporting for Members in the Public Sector

CHARTERED PROFESSIONAL ACCOUNTANTS ALBERTA

PROFESSIONAL ENGAGEMENT GUIDE

Highlights

- The Professional Engagement Guide (PEG) will be released during the spring of 2017
- A practitioner resource centre will be added to the Knotia platform with the following features:
  - Quick links to types of engagements and related content
  - Message centre to convey PEG specific communications (what's new, etc.)
  - Links to other relevant resources

Content

- Existing legacy publications (CPEM and PPM) will continue to be provided to subscribers pending the release of the PEG
- Incorporates changes (core concepts and forms/checklists) relating to the new Review Engagement Standard
- The audit methodology has been amended to include 12 steps (down from 14 steps) as a result of consolidating several steps relating to risk assessments
- An additional case study has been added for not-for-profit entities
- Inclusion of Excel based audit programs which, depending on how questions are answered, stream lines the process to identify only the required forms to be filled out (reactive, response based)
  - Classic forms – automated forms referred to as the "Structured Forms"
  - Simple forms – new program, designed for a simpler audit in excel based platform
- Practitioners who chose not to use the excel based forms can continue to use the Classic Forms, which were provided with CPEM and updated for the PEG

Subscribers

- Existing PPM and CPEM subscribers will receive the PEG as part of their subscription
- PPM will continue to be available to subscribers until either December 31, 2017 or April 30, 2018 (not yet decided)
- Subscribers can continue/cancel their subscription at their next subscription renewal date