



Memorandum

To	All Practising Offices	From	The Office Practice Assistance Committee
Subject	FOCUS ON PRACTICE INSPECTION		
Date	November 2011		

The Office Practice Assistance Committee (OPAC) reviews the annual practice inspection results to identify those areas where adherence to *CICA Handbook* recommendations could be improved. This memorandum outlines the common findings from inspections conducted between September 2010 and August 2011, provides direction for addressing deficiencies and summarizes significant new accounting and assurance standards and sources of guidance to assist practitioners in implementing the new standards. In addition, this memorandum provides an overview of some of the projects and ongoing activities of the Accounting Standards Board and the Auditing and Assurance Standards Board.

FINANCIAL STATEMENT PRESENTATION AND DISCLOSURE

CICA Handbook – Accounting

Accounting standards for all entities outside the public sector are issued by the Accounting Standards Board (AcSB). The AcSB approved significant revisions to the *CICA Handbook - Accounting* to reflect changes in Canadian GAAP. The revised *Accounting Handbook* includes the following sections:

- Part I – International Financial Reporting Standards
- Part II - Accounting Standards for Private Enterprises
- Part III – Accounting Standards for Not-for-profit Organizations
- Part IV - Accounting Standards for Pension Plans
- Part V – Pre-changeover Accounting Standards

Parts I, II and IV are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 while Part III is effective for annual financial statements relating to fiscal years beginning on or after January 1, 2012. Although early adoption is permitted for all Parts of the *Accounting Handbook*, the majority of financial statements inspected during 2010-2011 were prepared in accordance with *Part V – Pre-changeover Accounting Standards*.

The following sections outline the more common financial statement presentation and disclosure deficiencies noted during inspections conducted between September 2010 and August 2011. In addition, new financial statement presentation and disclosure requirements for the year of transition to new financial reporting frameworks and subsequent financial statements are highlighted.

Part II - Accounting Standards for Private Enterprises

Accounting standards for private enterprises (ASPE) were derived from existing standards in the *Accounting Handbook* and therefore many of the recognition, measurement and presentation requirements have not changed. As a result, many of the deficiencies noted in financial statements prepared in accordance with the new ASPE framework are the same as those noted in financial statements prepared in accordance with pre-changeover accounting standards. Following are common deficiencies that are relevant under both *Part II* and *Part V*.

- Classification of demand loans and related party loans with no fixed terms of repayment as long-term when file documentation supported a current liability classification. Callable debt with term provisions for repayment where the lender has not signed a waiver should be classified as current as required by *Part V* - EIC 122 and *Part II* – Section 1510.
- Lack of disclosure of revenue recognition policies for all significant revenue streams as required for profit-oriented entities in accordance with *Part V* - Section 1505.09 and EIC141 and *Part II* – Section 3400.31.
- Inadequate disclosure of the description of the relationship and measurement basis for related party transactions in accordance with Section 3840 (*Part V* and *Part II*).
- Inadequate inventory disclosures in accordance with Section 3031 (*Part V* and *Part II*).

The differential reporting options available under pre-changeover accounting standards have either been incorporated into the relevant sections in *Part II* as accounting policy choices (accounting for subsidiaries, significantly influenced investees and joint ventures and accounting for income taxes) or removed. Under *Part II*, redeemable preferred shares issued as part of a tax planning strategy **must** be recognized in equity until a demand for payment is made. This may result in a change when adopting *Part II* if redeemable preferred shares under pre-changeover GAAP were classified as a liability (ie. the differential reporting option was **not** elected). Many of the disclosure requirements related to the application of differential reporting options have been carried forward to *Part II*. The following common deficiencies are relevant under both *Part II* and *Part V*.

- Lack of disclosure of a reconciliation of actual taxes to taxes that would result from application of the statutory rate when the taxes payable method of accounting for income taxes is used.
- Inadequate disclosure when the differential reporting option to present redeemable preferred shares issued in tax planning arrangements as equity is applied. The following presentation and disclosures are required under both *Part V* (with the differential reporting option) and *Part II* (for all redeemable preferred shares issued in a tax planning arrangement):
 - presentation as a separate line item in the equity section of the balance sheet disclosing, on the face of the balance sheet, the total redemption amount for all classes of such shares outstanding;
 - the aggregate redemption amount for each class of such shares; and
 - the aggregate amount of any scheduled redemptions required in each of the next five years.

The ASPE framework contains many simplifications in measurement, most notably in the areas of financial instruments, asset retirement obligations, employee future benefits, development costs, goodwill and stock-based compensation. In addition, required note disclosures have been significantly reduced. Although there are fewer requirements for disclosure of assumptions, reconciliations and detailed breakdowns of balance sheet and income statement amounts, one significant disclosure has been added: the disclosure of the amount payable at the end of the period in respect of government remittances, other than income taxes. This required disclosure was often omitted in the financial statements prepared in accordance with ASPE that were inspected during 2010-2011.

Other deficiencies noted in the financial statements prepared in accordance with ASPE are as follows:

- Lack of presentation of a cash flow statement. In accordance with *Part II* – Section 1540, a cash flow statement must be presented as an integral part of the financial statements.
- Lack of appropriate disclosure of the basis of accounting. In accordance with *Part II* – Section 1400, the basis of presentation must be stated prominently in the financial statement notes.

The specific requirements in the year of transition to ASPE were addressed well in the limited number of transition financial statements inspected during 2010-2011. Practitioners are reminded of the following requirements addressed in *Part II* – Section 1500, First-time adoption:

- **Opening Balance Sheet**
An opening balance sheet is prepared and presented at the date of transition which means a third balance sheet is presented in the year of adoption of ASPE. The date of transition to ASPE is the beginning of the earliest period for which an entity presents full comparative information under the new standards. For example, if an entity first adopts ASPE for the December 31, 2011 financial statements the date of transition would be January 1, 2010. The balance sheet would show comparative figures for December 31, 2010 and January 1, 2010.
- **Accounting Policies - Retrospective Application**
The same accounting policies must be applied to the opening balance sheet and throughout all periods presented in the first financial statements prepared using ASPE. The standards are to be adopted retrospectively where no specific elective exemption is available or where retrospective application is not specifically prohibited.

In February 2011, the AcSB issued amendments to Section 1500, *First Time Adoption – employee future benefits exemption* - to permit an entity that accounts for its defined benefit plans using the deferral and amortization approach described in Section 3461, *Employee Future Benefits*, in Part II of the *Handbook*, to carry forward at the date of transition to ASPE any unrecognized actuarial gains and losses and past service costs that were determined previously in accordance with Section 3461 in Part V of the *Handbook*.

- **Other Disclosure**
In the year of adoption of ASPE, the financial statements must disclose:
 - A reconciliation of net income reported in the most recently issued statements to net income under ASPE for the same period;
 - Amount and explanation for each charge to retained earnings at the date of transition; and
 - The exemptions the entity elected to use in the preparation of the financial statements.
- **Reporting Implications of Adoption of New Financial Reporting Frameworks**
Unless the auditor or accountant has been specifically engaged to perform an audit or review of the prior year financial statements and the opening statement of financial position prepared in accordance with the new **financial reporting framework**, the prior year figures are considered unaudited. In accordance with CAS 710, an Other Matter paragraph stating that the corresponding figures are unaudited must be included in the independent auditor's report. If a review engagement is performed, the fact that the corresponding figures were not reviewed should be included in the review engagement report or disclosed in the notes to the financial statements or the corresponding figures must be clearly marked as not reviewed on the face of the financial statements.

Resources

- **CICA Handbook – Accounting Part II**
- **Canadian Standards in Transition website** – the Private Enterprises section of the website includes various resources for communication and implementation, such as:
 - Free online course – *Introduction to Accounting Standards for Private Enterprises “ASPE”*
 - FAQs
 - Transition guidance
 - *Conversion to Accounting Standards for Private Enterprises – Basic Transition Steps*
 - *ASPE – Transition Considerations for a Non-Complex Entity* (March 2011)
 - *ASPE: A Guide to Understanding Transitional Options and Accounting Policy Choices* (June 2011). This publication includes transition financial statements and sample notes.
 - *First-Time Reporting on Financial Statements – Adopting Accounting Standards for Private Enterprises*
 - Sample Financial Statements
 - *A Case Study: Financial Statement Comparisons*
 - Webinars (archived on the Transition website)
 - *Financial Instruments : A New Standard for Private Enterprises* (February 2011)
 - *Transitioning to Private Enterprise Standards* (November 2010)
 - Articles
 - *ASPE – Fair Value Option of PPE & First-Time Adoption*
- **Provincial Institute PD** – the seminar, *ASPE – A Comparison to Part V* is being offered in the Fall/Winter program. In addition, an online course, *ASPE: A Survey of the Standards* is available through the Institute’s PD program.
- **CPEM** – The 2011 edition includes forms containing the most common financial statement presentation and disclosure requirements.
- **Model Financial Statements – Private Enterprises Part II of the CICA Handbook - Accounting** – available through CAstore.

Part III – Accounting Standards for Not-for-profit Organizations

Part III was published in early December 2010 to provide Canadian **private sector** not-for-profit organizations (NFPOs) with a new financial reporting framework. A not-for-profit organization that applies *Part III* also applies ASPE to the extent those standards deal with topics not addressed in *Part III*. *Part III* addresses standards and circumstances unique to the sector and carries forward the 4400 series from pre-changeover accounting standards in *Part V*.

Below is a list of common findings for NFPO financial statements that are relevant under both *Part III* and *Part V*.

- Lack of disclosure of revenue recognition policies for contributions and other significant revenue streams.
- Inadequate disclosure relating to the allocation of general expenses in accordance with Section 4470 of both *Part III* and *Part V*.
- Inadequate disclosures relating to cash flows in accordance with Section 1540 of both *Part II* and *Part V*. It should be noted that under *Part II* a cash flow statement **must** be presented as an integral part of the financial statements.

The specific requirements in the year of transition to accounting standards for not-for-profit organizations are included in *Part III* - Section 1501; however, they are the same as those for ASPE (see section above).

Resources

- **CICA Handbook – Accounting Part III**
- **Canadian Standards in Transition website** – the Not-for-Profit Organizations section of the website includes:
 - *Private Sector FAQ: Accounting Standards for Private Sector Not-for-profit Organizations* (Note: Additional resources are expected to be added to the transition website. As the requirements in the year of transition are the same as those for private enterprises, members should view the resources in the ASPE section of the website)
- **Provincial Institute PD** – practitioners interested in learning the standards should plan to attend the seminar, *Not-for-Profit Organizations – The New Accounting Standards* which is being offered in the Fall/Winter PD program.
- **Model Financial Statements** – Model Financial Statements for Not-for-profit Organizations, *Part III* of the *CICA Handbook – Accounting* are being developed and will be available through CAstore.

Part I - International Financial Reporting Standards

International Financial Reporting Standards (IFRS) are required for publicly accountable enterprises (PAE) and optional for private enterprises and non-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 business.

Generally speaking, *Part V – Pre-changeover Accounting Standards* and IFRS are similar in terms of the style and form of the individual standards. Both sets of standards are based on similar conceptual frameworks and generally reach similar conclusions. However, in addition to some pervasive differences, there are subtle differences in the details of scope, recognition, measurement and disclosure. The impact of adopting IFRS will vary by industry and individual organization.

Practitioners are reminded of the following requirements in the year of adoption of IFRS.

- **Opening Statement of Financial Position**
As with the adoption of other financial reporting frameworks discussed in sections above, an opening statement of financial position is required at the date of transition which means a third statement of financial position is presented in the year of adoption of IFRS.
- **Accounting Policies - Retrospective Application**
As with ASPE first-time adoption, IFRS 1 permits certain exemptions to retrospective application that can be applied on transition to provide some transitional relief and prohibits retrospective application of certain standards (exceptions). To provide a full understanding of the transitional effect, the entity's first set of IFRS financial statements must disclose all the exemptions for which the entity has elected to use in the preparation of its financial statements.
- **IFRS 1 Reconciliation**
To allow users to have a full understanding of the effect and implications of the transition to IFRS, IFRS 1 requires extensive disclosure and reconciliation of equity and total comprehensive income in the most recently issued financial statements to equity and total comprehensive income under IFRS for the same period. This is required in the first set of financial statements prepared under IFRS. If the entity is required to issue interim statements in accordance with *IAS 34 Interim Financial Reporting*, this would be required for the first set of interim financial statements issued in accordance with IFRS. Once the entity has adopted and issued a first set of IFRS financial statements with an explicit statement of compliance, IFRS 1 will no longer be applicable.

In the year of adoption and subsequent years, the basis of accounting must be adequately disclosed. 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. If desired, such entities may also make the additional statement that the financial statements are in accordance with Canadian GAAP.

It should be noted that additional requirements and disclosure may be required if the entity files with the securities commission (*NI 51-102 Continuous Disclosure Obligations*).

Resources

- ***CICA Handbook – Accounting Part I***
- **Canadian Standards in Transition website** – the IFRS section of the website contains comprehensive information and learning resources on the transition to IFRS, such as on-line courses, presentations, articles, guidance on standard and industry specific issues, as well as sample financial statements. It also includes a separate webpage that provides a selection of transition resources for small and mid-sized companies. Specifically, the following resources are provided:
 - *Comparing Canadian GAAP & IFRS*
 - *Standards Compliance Checklists and Questionnaires*
 - *Assurance Implications of the Changeover to IFRS*
- **Provincial Institute PD** – An IFRS update is being offered as part of the Fall/Winter PD Program. In addition, an online course, *IFRS: A Survey of the Standards* is available through the Institute's PD program.

CICA 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. Adoption of the new strategic plan by the AcSB made it necessary for PSAB to consider the future financial reporting for certain government organizations. The following decisions have been made:

- Government business enterprises (GBEs) – GBEs are required to follow IFRS for periods beginning on or after January 1, 2011.
- Other government organizations (OGOs) – OGOs must consider the needs of the users of their general purpose financial statements in determining whether standards in the Public Sector Accounting Handbook (PS Handbook) meet their needs and, if they do not, the organizations would follow IFRS for periods beginning on or after January 1, 2011.
- Government Not-for-profit Organizations (GNFPOs) - PSAB approved an amendment to the Introduction to Public Sector Accounting Standards and eight new Handbook Sections, PS 4200 to PS 4270 (the 4400 Series from *Part V* - pre-changeover accounting standards). The amendment to the Introduction directs all GNFPOs to follow the PS Handbook for fiscal years beginning on or after January 1, 2012. GNFPOs can choose to follow the PS Handbook, including Sections PS 4200 to PS 4270 or, alternatively, the PS Handbook without Sections PS 4200 to PS 4270.

The decision tree in Appendix A will help organizations determine which basis of accounting they should follow. Consideration must be given to the definitions of control, GBE and GNFPO when applying the decision tree. These definitions can be found in the Introduction to Public Sector Accounting and PS 1300.

Below is a list of the common findings for public sector financial statements noted during the past inspection cycle.

- Lack of disclosure of budgeted amounts on the Statement of Operations and Statement of Change in Net Debt in accordance with PS 1200.122.123
- Presentation of net debt and changes in net debt were not in accordance with PS 1200.

Resources

- **CICA Public Sector Accounting Handbook**
- **Canadian Standards in Transition website** - the Public Sector section of the website includes the following resources:
 - *Summary comparison of CICA Public Sector Accounting Handbook and CICA Handbook - Accounting (June 2011)*
 - *Determining an Organization's Basis of GAAP (see Appendix A)*
 - *Public Sector FAQ: Accounting Standards for Government Not-for-profit Organizations (GNFPOs)*
 - *GAAP Comparison for Government Not-for-profit Organizations*
 - *Public Sector Not-for-profit Organizations Face Decisions*
- **Provincial Institute PD** – the following seminars are being offered in the Fall/Winter PD program: *PSAB Update, PSAB Government Not-for-Profit Organizations* and *PSAB 101*.

AUDIT ENGAGEMENTS

Canadian Auditing Standards

The Canadian Auditing Standards (CASs) apply to **all** audits of financial statements for fiscal years ended on or after December 14, 2010, and replace the previous auditing standards in Canada. The CASs are substantially harmonized with International Standards on Auditing (ISAs).

For the upcoming year it is expected that the majority of audits will be performed under the CASs. In rare circumstances where a year end prior to December 14, 2010 is being audited, the previous standards will still be applicable. These standards continue to be available in the *CICA Handbook – Assurance – Assurance Handbook Prior to Issuance of CASs*.

With the implementation of the CASs, changes have been required in many aspects of the audit engagement including procedures, documentation, reporting, and client communications. However, the extent of the impact of the CASs on a particular firm depends on the firm's current programs as many of the new requirements may have already been implemented by firms as best practices.

Practitioners are reminded of the following areas of consideration in transitioning to the CASs.

- **Communications (CAS 260/265/450)**
Practitioners have seen changes in the required form, timing and general content for communications with management and those charged with governance. Specifically, significant audit deficiencies identified during the engagement must be communicated in writing. Furthermore, there is a requirement that any oral communications be documented together with the individual(s) with whom the discussions were held.

- **Requirement to Communicate Independence (CAS 260)**
 In contrast to the old standards, CAS 260 requires communication of independence only for listed entities. The Council Interpretations of the Independence Rules of Professional Conduct, Rules 204.1 – 204.6 were updated earlier this year and require members to establish policies and procedures for independence-related communications and to follow the requirements for annual communication of independence as set out in the *CICA Handbook – Assurance*.
- **Going Concern (CAS 570)**
 There was no equivalent to CAS 570 in the old standards. Practitioners should note that CAS 570 applies to **all** audits, even if it is evident that the entity is a going concern. Under CAS 570, an assessment of management's assumption of going concern is required as part of the auditor's risk assessment procedures. The auditor must discuss with management how they assessed the entity as a going concern and documentation of this discussion should be evident in the file. When conditions or events are identified that would give rise to significant doubt of the going concern assumption, this should be communicated with those charged with governance. In such circumstances, specific procedures should be performed, including evaluating management's plans for future actions. The auditor also shall request written representation from management and, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.
- **Materiality (CAS 320/450)**
 The CASs require the assessment of materiality at two levels: overall materiality for the financial statements as a whole and performance materiality. When applicable or desirable, the materiality level for a particular class of transaction, account balance or disclosure may also be calculated. The concept of performance materiality may be new to some practitioners. This is the level of materiality that must be used in the determination of the nature, extent and timing of audit procedures and is calculated to allow a cushion for misstatements that may not be uncovered through audit testing. Factors to be considered in determining materiality are included in the CASs. Also new is the explicit requirement that, where applicable, materiality be re-assessed and revised as the audit progresses.
- **Related Parties (CAS 550)**
 CAS 550 provides explicit requirements for the risk assessment procedures and other procedures that the auditor shall perform with respect to related party transactions. The auditor is required to inquire of management and others to obtain an understanding of controls, if any, that are established to identify, account for and disclose related party relationships and transactions in accordance with the applicable financial reporting framework. CAS 550 also indicates that any related party transactions outside the normal course of business should be deemed "significant risks" and treated as such in planning the audit approach.
- **Group Audits (CAS 600)**
 CAS 600 has a broad scope and practitioners are encouraged to familiarize themselves with the standard as it may apply in more cases than the previous standard - Section 6930, *Reliance on Another Auditor*. CAS 600 applies to the audit of consolidated financial statements of a parent and its subsidiaries when other auditors are involved in auditing one or more of the components, but it can also apply when the audit does not include subsidiaries or the work of other auditors. The standards can apply when the audit is performed by different auditors within the same firm or office. The key driver for CAS 600 is whether the components are significant to the preparation of the entity's financial statements.

The concept of reliance on another auditor in the previous standards under Section 6930 does not exist in CAS 600. The standard clearly emphasizes and provides specific requirements and guidance on the overall responsibilities of the group engagement team.

- **Audit Sampling (CAS 530)**

CAS 530 is a new standard in that the old standards did not have a specific section devoted to audit sampling. Section 5030.14 to .17, *Audit Evidence* provided limited guidance on sampling and other means of selecting items for testing but it did not provide the level of detail found in CAS 530. Specifically emphasized in CAS 530 are the documentation requirements related to sample design, calculation of sample size, selection of items for testing and audit procedures performed. Further guidance is given on the documentation of investigating the nature and causes of deviations, evaluating the results and concluding on the results of the testing with respect to the population being tested.

- **Audit Reporting Model (CAS 700/705/706)**

The most significant change practitioners and users of financial statements have seen as a result of the implementation of the CASs is the audit reporting model. Determination of the appropriate audit reporting model is impacted by the purpose of the financial statements. The appropriate audit reporting model must be considered at the pre-planning stage and may impact the decision to accept the engagement. The preconditions for an audit clearly state that an applicable reporting framework, which is integral to the new audit reporting model, must be in place prior to acceptance of an audit engagement.

In addition to these pre-acceptance and planning considerations, the format and wording of the auditor's report has been expanded. The concepts of Emphasis of Matter and Other Matters paragraphs have been added which allow the auditor to highlight certain items directly in the audit report. Certain CASs specifically require the use of an Emphasis of Matter paragraph. CAS 570.19 requires the use of the Emphasis of Matter paragraph even when there is adequate disclosure of material uncertainty regarding the going concern assumption in the notes to the financial statements. Practitioners should also review CAS 210.19(b); CAS 560.12(b) and .16 and CAS 800.14 for other areas where the Emphasis of Matter paragraph is required. However, practitioners are cautioned that, while the Emphasis of Matter paragraph should be used to highlight matters fundamental to the users' understandability of the financial statements, careful consideration should be used when deciding which matters to include so as not to diminish the effectiveness of the Emphasis of Matter paragraphs.

As a result of the complexities relating to the changes to accounting and auditing standards, the CICA has published a guide, *Audit Reporting Implications of New Auditing and Accounting Standards* to promote consistency in the form and content of audit reports by providing guidance with respect to commonly occurring circumstances. The guide addresses frequently asked questions and provides illustrative audit and review engagement reports under various circumstances. The guide is located on the Canadian Standards in Transition website.

- **Dating of the Audit Report (CAS 700)**

CAS 700 relating to dating the audit report is a significant change from the old standard in Section 5405. CAS 700 requires the audit report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that (a) all the statements that comprise the financial statements, including related notes, have been prepared and (b) those with the recognized authority have asserted that they have taken responsibility for those financial statements. This will generally be no earlier than the date of approval of financial statements by the Board or other similar body (not the audit committee or equivalent).

The change in audit report date has generated some concern regarding the impact on year end procedures such as obtaining the legal letter and subsequent event testing. Recognizing the challenges this creates in obtaining legal letters from the client's legal counsel, *AUG-46, Communications with Law Firms under new Accounting and Auditing Standards*, was issued to provide guidance on communications with lawyers.

Common Findings – Audit Engagements

While the majority of engagements inspected in the past inspection cycle were conducted under the old standards, many of the common findings related to the risk based approach to auditing and documentation are applicable under the CASs. These findings continue to be consistent with matters noted in prior years. The findings that impact the CAS audit are noted as follows:

- **Understanding the control environment, the entity’s risk assessment process and implementation of internal control (CAS 315)**
 Whether or not a control reliance strategy is planned, an understanding of internal controls, including the control environment, information systems and business processes is required for all financial statement audits. In addition to gaining this understanding, the auditor shall evaluate the effectiveness of the design of the controls and assess whether the controls have been implemented (usually through a walkthrough of the system). Practitioners need to be aware that evaluating the design and assessing the implementation of internal controls is **required regardless of audit strategy and nature and size of entity.**
- **Assessment of the risk of material misstatement (CAS 315)**
 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. In assessing the risk of material misstatement, fraud risk factors and significant risks should be considered. 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 the auditor's further audit procedures
- **Consideration of the risk of material misstatements in the financial statements due to fraud (CAS 240)**
 The auditor is required to obtain an understanding of management’s assessment of the risk of material misstatement due to fraud, the internal controls in place to address such risk and to prevent fraud and management’s awareness of any known or suspected fraud. The planning documentation should include evidence that the audit team (or sole practitioner) has considered the susceptibility of the entity’s financial statements to misstatement due to fraud. In addition, documentation in the file should include evidence that the auditor has made enquiries of management and those charged with governance regarding fraud.
- **Use of analytical procedures (CAS 315/520)**
 The auditor should use preliminary analytical procedures as part of the risk assessment process to obtain an understanding of the entity and its environment. Analytical procedures should be performed with respect to revenue and consideration should be given to unusual or unexpected relationships that may indicate risk of material misstatement due to fraud.

In addition, the auditor should apply analytical procedures at or near the end of the audit to form an overall conclusion as to whether the financial statements as a whole are consistent with the auditor’s understanding of the entity. If such analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information, the auditor should investigate and obtain adequate explanations and appropriate corroborative audit evidence.
- **Documentation**
 Areas in which documentation weaknesses continue to be found include substantive audit procedures around testing of journal entries, management estimates, subsequent events review, revenue, expenses and payroll.

A very limited number of CAS audit engagements were inspected during the past inspection cycle. The following deficiencies were noted in many of these engagements files.

- Practitioners failed to issue the new form of audit report;
- The date of the audit report was the date of substantial completion of the examination rather than the date at which those with the recognized authority for the financial statements had accepted responsibility;
- Performance materiality was not assessed and documented;
- Communications with those charged with governance did not meet the standards;
- Related party enquiries were not conducted or were inadequate to meet the explicit requirements of the standards; and
- Where material uncertainty existed with respect to the going concern assumption, practitioners failed to include an Emphasis of Matter paragraph in the audit report highlighting the existence of material uncertainty and drawing attention to the note in the financial statements addressing the going concern assumption.

Other Audit Engagements

Canadian Auditing Standards are applicable to the audit of financial statements and other historical financial information. While they are written in the context of an audit of financial statements, they are to be adapted as necessary in the circumstances when applied to the audits of other historical financial information.

With the federal election in the Spring of 2011 and the provincial election this fall, many practitioners will likely find themselves being engaged to audit electoral candidates. To assist practitioners with the implementation of the CASs on these engagements, the CICA has updated its *Guide for the Auditor of a Candidate in a Federal Election Pursuant to the Canada Elections Act* to reflect the CASs. In addition, Elections Manitoba's *Audit Guide* was updated in 2010 to address the impact of the CASs.

Resources

- ***CICA Handbook – Assurance (previously Part I)***
- ***CICA Handbook – Assurance Handbook Prior to Issuance of CAS (previously Part II)***
- **Canadian Standards in Transition website** – the Canadian Auditing Standards section of the website includes various implementation and other resources, such as:
 - *CICA's Guide to new CASs in Canada*
 - CAS Support Tool (interactive)
 - *Canadian Auditing Standards Briefings* (guidance on significant changes to eight standards)
 - *Reporting on Financial Statements under Canadian Auditing Standards* (March 2011)
 - *Reporting Implications of New Auditing and Accounting Standards* (updated, August 2011)
 - *First-Time Reporting on Financial Statements – Adopting Accounting Standards for Private Enterprises*
 - Webinars (archived on the Transition website)
 - *Audit of a Micro Entity – Making the New Canadian Auditing Standards Work for You and Your Clients* (October 2010)
 - *The New Audit Reporting Model under Canadian Auditing Standards* (September 2010)
 - Articles
 - *CA Magazine* (November 2009) – *Staying out of the rough*
 - *CA Magazine* (March 2010) – *How much is enough?*
 - *CA Magazine* (April 2010) – *The CAS audit*
 - *AASB Newsletter* (March 2011) – *Recent Handbook Changes*

- **Provincial Institute PD** – The seminar, *The CAS Audit of a Very Small Entity* is being offered in the Fall/Winter PD program. In addition, an online course, *Auditing in the New CAS Environment* is available through the PD program.
- **CPEM** – the 2011 *Canadian Professional Engagement Manual (CPEM)* is available through CAstore.

REVIEW ENGAGEMENTS

New Guideline on Dating of the Review Engagement Report

Assurance and Related Services Guideline, *AuG-47, Dating of the Review Engagement Report*, was issued in December 2010. The guideline provides guidance on how the concept of substantial completion is applied and clarifies that the review engagement report is dated as of the date of substantial completion of the review. This guideline was determined to be necessary as the only standard that addresses substantial completion, Section 5405, *Date of the Auditor's Report*, does not exist in the new *CICA Handbook - Assurance*.

Describing the Financial Reporting Framework in the Practitioner's Report

With the restructuring of the *CICA Handbook - Accounting* to include various different financial reporting frameworks in Canadian GAAP, the reference to "Canadian Generally Accepted Accounting Principles" in the practitioner's report is no longer descriptive enough. Both the financial statements and the practitioner's report will need to reference the exact financial reporting framework that is being applied.

As a result of the complexities relating to the changes to accounting and auditing standards, the CICA has published a guide, *Audit Reporting Implications of New Auditing and Accounting Standards* to promote consistency in the form and content of audit and review reports by providing guidance with respect to commonly occurring circumstances. The guide addresses frequently asked questions and provides illustrative audit and review engagement reports under various circumstances. The guide is located on the Canadian Standards in Transition website.

Common Findings – Review Engagements

Notwithstanding the upcoming changes affecting review engagements, the following matters have been identified for consideration in review engagements based on the experience of the practice review program in the prior year.

- **Inter-relationship/comparison of revenues, expenses, gross margin, operating ratios and balance sheet items**
The lack of documentation of an analytical review of the financial statements is considered to be a serious deficiency. The Committee noted that the practitioner should focus on key financial statement items or aspects of the client's business, and ensure that checklists, where used, are supplemented by further appropriate documentation. Even if there are no unusual amounts, variances or trends, a comment on the plausibility of key items should be included on the checklist or referenced to a specific working paper as evidence that the practitioner gave such items due consideration.
- **Cut-off procedures**
Checklist questions usually suggest that additional documentation be included in either the working papers (cross-referenced to the checklist) or the comments column of the checklist. Typically, documentation would include a description of procedures followed by the client to ensure proper cut-off, a conclusion on the adequacy of the procedures and, if deemed necessary, details of any additional review procedures required to assess plausibility of the statements.

Documentation of discussions with clients would include the name of the individual(s) with whom the matters were discussed and the date of the discussions. Completion of only a checklist without additional comments is not considered to be sufficient documentation of enquiry, analytical procedures and discussion.

- **Inventory – client’s count procedures and valuation**

As noted above with respect to cut-off procedures, completion of checklists without additional documentation is not considered sufficient. A description of inventory count procedures should include more than just the date of the inventory count; matters such as count instructions, use of count tags, supervision, segregation of obsolete and slow-moving inventory and inventory on consignment should be noted. The client’s basis of valuation, including how “cost” (FIFO, specific item, etc.) is determined, should be documented.

Resources

- ***CICA Handbook – Assurance Part I***
- ***CICA 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.
- ***CICA Assurance and Related Services Guideline AuG-47, Dating the Review Engagement Report on Financial Statements***
- ***Canadian Standards in Transition website – Canadian Auditing Standards***
 - *Reporting Implications of New Auditing and Accounting Standards* (updated August 2011)
 - *First-Time Reporting on Financial Statements – Adopting Accounting Standards for Private Enterprises*
- **Provincial Institute PD** – a seminar on review and compilation engagements is being offered as part of the Fall/Winter PD program

QUALITY CONTROL POLICIES AND PROCEDURES

CSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*, was effective December 15, 2009. Therefore, firms should ensure that their quality control policies and procedures have been updated and are in compliance with the standard.

CAS 220 *Quality Control for an Audit of Financial Statements*, which is effective for audits of financial statements for periods ended on or after December 14, 2010, is premised on the basis that the firm is subject to CSQC 1, or an equivalent. However, the CASs are only applicable to audits of financial statements and other historical financial information. Section 5030 is still in effect for all other assurance engagements and practitioners are reminded that CSQC 1 does not override the requirements of Section 5030.

Common Findings – Quality Control

Monitoring of the Firm’s Quality Control Policies and Procedures

The main 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 including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner.

Annual monitoring involves reviewing established quality control policies and procedures to determine whether they remain appropriate given changes in standards and changes in the firm and evaluating the system to ensure it is operating effectively and being complied with in practice. Annual monitoring is 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 is not being retained. Where annual monitoring has been completed, firms should ensure that they retain documentation of the monitoring and the communication of the results.

With respect to the cyclical monitoring requirements, CSQC 1 requires that those performing the engagement or the engagement quality control review not be involved in the cyclical inspection of the completed files. As a result, smaller firms may need to look for an external monitor to do the inspection of individual engagements on a cyclical basis. Practitioners are reminded that the provincial institute reviews are not a substitute for the requirement that the firm conduct its own cyclical inspections of completed assurance engagements.

Resources

- ***CICA Handbook – Assurance Part 1***
- ***Quality Assurance Manual (QAM)***

COMPILATION ENGAGEMENTS

Common Findings

Assessment of Independence

Rule 204.8 applies to compilation engagements. The performance of a compilation does not require that the accountant be independent; however, any activity, interest or relationship that may impair the accountant's independence should be disclosed in a separate paragraph in the notice to reader communication. It is therefore necessary to assess independence for compilation engagements and it is recommended that this assessment be documented and maintained in the engagement file.

WHAT THE FUTURE HOLDS

Auditing and Assurance Standards Board

Standards for Compilation Engagements

The AASB recently approved a project to revise Section 9200, *Compilation Engagements*. The objectives of this project are:

- to develop a clarified standard that would provide guidance on specific matters that have caused confusion and ambiguity in performing compilation engagements; and
- to improve the quality of information provided to users of compiled financial statements, based on sound research and extensive consultation.

Initially this project will involve conducting research that primarily focuses on seeking views of users of compiled financial statements on the relevance of this service to their needs, with the objective to better understand the nature and extent of public interest issues, if any, that this project should address. Taking into account the results of this research and the input received to date, the AASB will decide on the nature and extent of revisions that should be made to Section 9200.

Standards for Review Engagements

The AASB also has a project to revise the standards for review engagements to improve the robustness of the standards by reflecting current practice and appropriately addressing the needs and issues raised by practitioners and other Canadian stakeholders. The key issues that the project addresses are:

- the need for a set of review engagement standards that stand alone;

- the determination of the nature and extent of review engagement procedures; and
- consideration of the form and content of the practitioner's report.

The AASB is monitoring the International Auditing and Accounting Standards Board's project to revise International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*. The AASB will review the analyses of issues pertaining to the proposed revised ISRE 2400 in March and June 2012. The activities beyond June 2012 are dependent on whether or not the AASB decides to adopt the revised ISRE 2400 or to develop a unique Canadian standard for review engagements. A decision to adopt the international standard would be subject to public comment from Canadian Stakeholders.

Practitioners are encouraged to stay connected with these projects and provide input through the AASB website: www.aasbcanada.ca

Accounting Standards Board

Accounting Standards for Private Enterprises

The AcSB has committed to making substantive changes to private enterprise standards in the *CICA Handbook – Accounting Part II* no more frequently than every two years with the first major improvements to be issued in late 2013 with an effective date no earlier than fiscal years beginning on or after January 1, 2014. Exposure drafts for major improvements will be issued in late 2011 and 2012. The sections to be considered include:

- Agriculture;
- Consolidations;
- Discontinued Operations;
- Employee Future Benefits;
- Fair Value Measurement;
- Financial Statement Concepts; and
- Joint Arrangements.

The AcSB will also be making annual improvements which consist of relatively limited amendments to clarify guidance or wording in standards, or to correct for relatively minor unintended consequences, conflicts or oversights. The first set of annual improvements was released in October 2011 to be effective for periods beginning on or after January 1, 2011. The amendments include:

- Section 1400 *General Standards of Financial Statement Presentation* - paragraph 11A has been added to require an enterprise to present only one set of general purpose financial statements in any period and to refer to these statements in any additional sets of financial statements prepared;
- Section 1521 *Balance Sheet* - paragraph 5 was amended to address an inconsistency with Section 1510 *Current Assets and Current Liabilities*;
- Section 3064 *Goodwill and Intangible Assets* was amended to clarify that the requirement to charge expenditures on advertising and promotion activities to income includes mail order catalogues and other similar documents intended to advertise goods, services or events to customers;
- Section 3820 *Subsequent Events* - paragraph .07A was amended to clarify the meaning of the date of completion of the financial statements to be consistent with recent changes to the CAS. The financial statements are complete when a complete set of financial statements, including all required note disclosures, has been prepared, all final adjusting journal entries have been made including the adjustments for income taxes and bonuses, no changes to the financial statements are planned or expected and the financial statements have been approved in accordance with the

entity's process to finalize its financial statements. The date of completion of the financial statements affects the cut-off date for identifying and considering the effects of subsequent events; and

- Section 3856 *Financial Instruments* was amended to address recently identified issues that make the hedging requirements difficult for many affected private enterprises to apply.

International Financial Reporting Standards

The AcSB monitors all International Accounting Standards Board's projects and activities and publishes exposure drafts to incorporate revisions to IFRS into Canadian GAAP.

Practitioners are encouraged to monitor the AcSB projects and provide input through their website at www.acsbcanada.org.

APPENDIX A

Determining an Organization's Basis of GAAP