Focus on Practice Review Reportable Deficiencies 2019

January 2020

CPA Alberta's Practice Review program plays an essential role in protecting the public by assessing firms' compliance with professional standards, taking appropriate follow-up action or remedial action in instances of non-compliance, and providing one-on-one education to firms.

Our professional and regulatory landscapes continue to change, and will maintain our oversight while proactively addressing change. In the coming years, practitioners will face challenges relating to artificial intelligence, enhanced data analytics, new and unique industries and changes to professional standards. We will be monitoring how practitioners address these challenges.

In this report, the results of practice review and observations and suggestions for improvement are highlighted to assist practitioners in performing high quality engagements.

BACKGROUND

The Practice Review Committee (Committee) is comprised of twelve CPA members and one public member who are appointed by the CPA Alberta Board. Geographic location and practice size are considered in determining Committee membership. As well, the Committee collectively possesses experience and technical knowledge on a broad range of circumstances and industries, including accounting and auditing relating to reporting issuers, local governments, not-for-profit organizations, pension plans and private enterprises. This also includes assurance and compilation engagements.

Practice reviews of firms are undertaken not less than once every three years, providing that a comply assessment regarding adherence to professional standards is obtained. If a practice review does not result in a comply assessment, a follow-up practice review is done within one year from the initial review. The practice review cycle is also adjusted by considering risk indicators including date of registration with CPA Alberta and the Canadian Public Accountability Board (CPAB), significant changes in scope of practice, type of clients or composition of registrant, failure to meet CPD requirements, weak practice review results, disciplinary information, and any other information warranting an increased rate of practice review.

The Committee assesses practice review reports on an anonymous basis, together with any comments received from firms. The Committee determines whether each practice review complies in whole or in part with the *Rules of Professional Conduct* and practice standards and ensures a final practice review report is sent to the firm whose practice was reviewed. The Committee may also do one or more of the following:

- Direct a follow-up practice review;
- Direct the establishment and implementation of a professional development plan, or a plan to maintain and improve professional standards;
- Direct that courses, examinations, tutorial or other forms of CPD or skills training be taken;
- Recommend practice improvement, practical experience or the engagement of a mentor;
- Make a complaint to the Complaints Inquiry Committee (CIC).

Factors considered by the Committee in determining the action to be taken following a practice review may include, but are not limited to:

- The nature and severity of identified deficiencies;
- The number of identified deficiencies;
- The firm’s response to identified deficiencies including those requiring remedial action;
- The firm’s quality control systems and whether monitoring was performed;
- The cooperation of the firm;
- The public interest; and
- In a follow-up practice review, the results of the initial review and the degree to which the firm addressed identified deficiencies.

Referral to the CIC occurs when the Committee concludes its directed remedial action has not been effective and other consequences are required to protect the public. Matters referred to the CIC include a breach of the *Rules of Professional Conduct*, not cooperating with the practice review process, choosing not to take the CPD directed by the Committee, performing an engagement the firm is not registered to perform, and continual lack of success adhering to professional standards.

This past year, 536 practice reviews were completed (prior year - 546), of which 39 required a follow-up practice review (prior year - 23). The Committee directed 50 professional development courses to be attended (prior year - 40) and made two complaints to the CIC (prior year – four).

PRACTICE REVIEW OBSERVATIONS

Below are critical deficiencies identified during practice reviews. These include material misstatements identified in financial statements and, with respect to engagement performance, the most significant deficiencies that may have a great impact on the quality of work performed. Given the seriousness of these deficiencies, the Committee requires the firm’s remedial action plan when making its assessment on compliance. If the firm’s remedial action plan is not satisfactory to the Committee, it may consider the firm a serious risk to the public, resulting in an assessment of non-compliance with professional standards and related consequences.

It is important to note that Practice Review does not set standards. Professional standards are set out in the *CPA Canada Handbooks*, the *Chartered Professional Accountants Act (Alberta)* and CPA Alberta’s Bylaws, Regulations and *Rules of Professional Conduct*. Tax management standards are approved by the CPA Alberta Board and set out in the Directives.

I. FINANCIAL STATEMENT PRESENTATION

Financial statements with material misstatements are concerning since users may be inappropriately relying on incorrect financial information. These misstatements may be as a result of an error or of a financial statement misclassification.

When such deficiencies are identified during the practice review process, practitioners are encouraged to carefully consider not only the actions the firm will take on a go forward basis, but also whether the financial statements need to be restated.

DEBT DUE ON DEMAND

Callable debt includes any amount owing to another party when the creditor has the unilateral right to demand repayment of the debt. This includes loans from financial institutions and loans from related parties. Classification of these debts is based on facts existing at the Balance Sheet date, rather than on future expectations. If the creditor has waived, in writing, or subsequently lost, the right to demand payment for more than one year from the Balance Sheet date, then it is appropriate to present the debt as long-term. However, if the creditor has not waived, in writing, the right to demand repayment, then the debt should be classified as current. In the example of loans from related parties, even if these loans are subordinated to a financial institution, the creditor must still waive, in writing to the entity, the right to demand repayment in order to support the long-term classification.

When performing review or audit engagements, practitioners must perform and document their procedures to support the classification of callable debt. This may include reviewing loan agreements and the creditor's waiver of its right to demand repayment. In a review engagement, this may also include enquiring with the entity regarding its loan agreements and the creditor's waiver.

Practitioners must perform procedures with professional skepticism. For example, if a related party loan has no terms of repayment and in fact continues to be partially repaid during subsequent years, long-term classification may not be appropriate for the entire balance. This is the case even if the creditor has waived, in writing, its right to demand repayment as the partial repayment seems to contradict the written waiver. In this instance, it may only be appropriate to partially classify a current and long-term portion.

[CPA Canada Handbook – Accounting Part II; 1510.12-.13 and CPA Canada Handbook – Accounting Part III; 4400.21]

RECEIVABLES WITH NO TERMS OF REPAYMENT

Current assets include those assets ordinarily realizable within one year from the date of the Balance Sheet. Therefore, practitioners must carefully consider whether it is appropriate to classify receivables with no terms of repayment as current assets. In many instances, it is more appropriate to classify as long-term assets. For example, consider a related party receivable with no terms of repayment, showing no repayments during the year and for which management represents the timing of future payments as unknown. In this instance, the amounts should be classified as long-term assets since they will not be realizable within one year from the date of the Balance Sheet.

When performing audit or review engagements, practitioners must perform and document their procedures to support the classification of receivables with no terms of repayment. This may include reviewing loan agreements and enquiring with the entity.

[CPA Canada Handbook – Accounting Part II; 1510.03 and CPA Canada Handbook – Accounting Part III; 4400.21]

OTHER ASSETS

Current assets include those assets ordinarily realizable within one year from the date of the Balance Sheet. In many instances, it is appropriate to classify other assets as long-term. For example, consider prepaid expenses or deposits which will be realized in more than one year from the date of the Balance Sheet: these must be presented as long-term assets instead of current assets.

Another example to consider is investments with maturities greater than one year from the date of the Balance Sheet. Examples of such investments would include treasury bills, investment certificates, and call loans. These must also be presented as long-term assets instead of current assets if the assets are not capable of prompt liquidation and maturities are greater than one year from the date of the Balance Sheet.

When performing audit or review engagements, practitioners must perform and document their procedures to support the classification of all assets. This may include reviewing supporting documentation and enquiring with the entity.

[CPA Canada Handbook – Accounting Part II; 1510.03-.07 and CPA Canada Handbook – Accounting Part III; 4400.21]

II. AUDIT ENGAGEMENTS

AUDIT PLANNING - ASSESSING RISK AND LINKAGE TO PROCEDURES

An audit plan is the foundation of an efficient and effective audit. Identifying, assessing and documenting risks are an integral part of the planning process. In identifying risks through the planning process, the auditor will need to obtain and document:

- An understanding of the entity and its environment;
- The entity's internal control systems, including the control environment, risk assessment process, information systems and monitoring controls; and
- Control activities relevant to the audit.

When risks have been identified and assessed, including any significant risks that encompass fraud risk, an audit plan should be established clearly linking the audit procedures to the identified risks. Such audit procedures should be designed to focus on accounts and assertions that represent the greatest audit risk. To ensure audit procedures are designed to address the identified risks, it is useful to document the purpose of the procedure, identifying the account and assertions being tested.

When planning an audit engagement, it is important to update and document planning decisions. Performing the engagement on the basis of "same as last year" could cause inefficiencies and lead to an ineffective audit, especially when changes have occurred in a client's operations.

[CPA Canada Handbook – Assurance; CAS 300, 315 and 330]

AUDIT SAMPLING

When conducting substantive procedures, an auditor commonly tests less than 100 percent of a balance or transaction stream. Instead, they will test a sample. When selecting a sample, practitioners should:

- Select a representative sample;
- Perform appropriate audit procedures; and
- Evaluate results to obtain reliable, relevant and sufficient appropriate evidence to form a conclusion on the population as a whole.

It is critical that the sample represents the population. For example, a practitioner may employ a standard sample size without regard to the nature of the population and the objectives of the procedure. Practitioners must ensure that all items in a population have an equal chance of being selected. Where populations can be disaggregated, for example in situations where there are multiple revenue streams, each distinct sub-population should be sampled independently.

When using audit sampling in an engagement, documentation should allow an experienced practitioner to replicate the test and reach the same conclusions. To meet the reperformance expectation, documentation should indicate the population being tested, how the sample size was determined, how the sample was selected, extrapolation of any errors, and the conclusions reached.

[CPA Canada Handbook – Assurance; CAS 530]

SUBSTANTIVE ANALYTICS

Substantive analytical procedures are often used on their own or in conjunction with other substantive procedures to provide evidence to support the audit opinion. In general, substantive analytical procedures are most effective when evaluating large volumes of transactions in a highly predictable environment.

In determining which audit procedures to design to address audit risks, practitioners should carefully consider the suitability of using substantive analytical procedures. The suitability of an analytical procedure will depend upon the practitioner's assessment of how effective the procedure will be in detecting a misstatement that may cause the financial statements to be materially misstated. The performance of simple year-over-year analytics generally does not meet the criteria of a substantive analytical procedure. Effective substantive analytical procedures require the development of expectations using reliable and accurate information, the determination of appropriate thresholds for further investigation, and the follow-up of outliers through discussion with management and by obtaining corroborating evidence.

When using substantive analytical procedures for audit evidence, documentation should clearly identify how the expectation is calculated, the threshold for further investigation, the explanation for any deviations from threshold, and the conclusions reached.

[CPA Canada Handbook – Assurance; CAS 520]

AUDITING REVENUE

Revenue is an area which often has unique risks and correspondingly has a greater susceptibility to material misstatement. Risks may arise both from complex recognition requirements related to the characteristics of revenue streams and the presumptive risk of fraud. We have identified instances in which practitioners did not plan and perform appropriate audit procedures to respond to these risks. For example, audit teams may not have evaluated different types of revenue that may give rise to fraud risks. As a result, procedures may not have been performed to address the risks related to each significant revenue stream.

Practitioners are reminded that there is a rebuttable presumption of significant risk in revenue. Where the practitioner has determined that, due to the nature of the revenue (e.g., non-complex, single revenue stream, etc.) there is no such significant risk, the reason for this assessment should be documented in the file.

[CPA Canada Handbook – Assurance; CAS 240 and 330]

AUDITING ACCOUNTING ESTIMATES

With increasing frequency, auditors are encountering areas in which estimates and judgment are essential in performing the audit. While some estimates may be simple, others can be complex and determined using information that may not be reliable or may be subject to management bias. These complex estimates may include the determination of percentage of completion in revenue recognition, impairment or recoverability of loans or investments and work-in-progress, or obsolescence in inventory.

When planning the audit, practitioners should make a robust assessment of the areas where complex estimates are used, and develop audit procedures that directly address the risks associated with those estimates. For example, when auditing the valuation of loans receivable (including those with related parties), practitioners should obtain evidence to support the recoverability of such loans. The procedure of reconciling or confirming the balance of a loan may provide evidence of its existence but provides no evidence to support valuation. Procedures performed to assess valuation may include the evaluation of forecasts or projections and the critical assumptions used by management in developing valuations.

[CPA Canada Handbook – Assurance; CAS 540]

USE OF INFORMATION PRODUCED BY THE ENTITY

In the course of performing an audit, the practitioner will often rely on information produced by the entity (IPE). This reliance is expected to increase in the future as systems and procedures become more automated. Practitioners may not always be aware of the extent of their use and reliance on IPE, and should consider creating an inventory of IPE when planning an audit. Examples of common audit sources which use IPE include aged accounts receivable listings, inventory obsolescence reports, and cash flow projections.

When performing an audit, practitioners will need to develop a validation approach to be able to rely on evidence that includes IPE. For example, when evaluating the adequacy of the allowance for doubtful accounts, practitioners often rely on an aged accounts receivable listing. In that case the practitioner should perform procedures to confirm that invoices have been properly classified in aging categories.

[CPA Canada Handbook – Assurance; CAS 500]

III. REVIEW ENGAGEMENTS

This is the first year in which the implementation of the new review engagement standard (Canadian Standard on Review Engagements, CSRE 2400) was included in our practice review program. The most significant changes resulting from the implementation of CSRE 2400 were requirements to:

- Design and perform review procedures for all material balances;
- Identify and focus on areas where material misstatement is likely to arise;
- Inquire with management and others within the entity regarding specific items, including the going concern assumption, significant accounting estimates, related parties, and fraud and non-compliance with laws and regulations;
- Expand documentation of the understanding of the entity’s accounting systems and records;
- Communicate specific items to management and those charged with governance; and
- Issue a new review engagement report with revised wording and requirements.

UNDERSTANDING THE ACCOUNTING SYSTEMS AND ACCOUNTING RECORDS

The client’s accounting systems and records form the basis of the financial statements and provide information relied upon during the review engagement. Therefore, understanding the accounting systems and records used by an entity is vital to performing a review engagement. This helps to identify areas where a material misstatement is likely to arise and the procedures to be performed, allowing the practitioner to focus analysis and inquiry on the right areas. Practitioners should document accounting systems and records in sufficient detail to enable an experienced practitioner, having no previous connection with the engagement, to understand. For example, brief and superficial documentation of accounting systems and records does not result in a meaningful analysis.

[CPA Canada Handbook – Assurance; CSRE 2400.43-.44]

AREAS WHERE MATERIAL MISSTATEMENTS ARE LIKELY TO ARISE

A critical element of CSRE 2400 is the identification of areas where material misstatements are likely to arise. If this assessment is not completed and documented, it is possible that appropriate inquiries and analytical procedures may not be designed and performed.

Inquiry and analytical procedures are required for all material items in the financial statements, including disclosures. When a practitioner has identified an area where material misstatement is likely to arise, additional procedures should be performed to focus on addressing the area. For example, a transaction or event outside of the normal course of business or a subsequent event, may be considered an area where material misstatement is likely to arise requiring focused procedures. These areas may not necessarily be material items in the financial statements.

[CPA Canada Handbook – Assurance; CSRE 2400.45-.46]

INQUIRIES OF MANAGEMENT AND OTHERS WITHIN THE ENTITY

Evidence obtained through inquiry is often the principal source of understanding concerning the entity's activities, management's actions during the year and their plans. CSRE 2400 includes an extensive list of required inquiries of management and others within the entity.

Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause the practitioner to believe the financial statements may be materially misstated. This analysis should not be performed as a perfunctory exercise. For example, more detail is required than one-word responses to inquiries that clearly require a more detailed response.

Going concern enquiries are particularly important. Management's responses to these enquiries may result in disclosure in the financial statements or changes to the measurement of amounts in the financial statements.

[CPA Canada Handbook – Assurance; CSRE 2400.47]

IV. QUALITY CONTROL

A well thought out and executed quality control system is required and reinforced with remedial action. If designed and implemented effectively, overall quality improves and deficiencies decrease.

One of the most effective components of quality control is the completion of monitoring as required by Canadian Standards on Quality Control 1 (CSQC 1). This monitoring is vital to ensure that the firm identifies and corrects any breakdown in quality controls in a timely manner. Practitioners should assess overall quality control annually and review completed assurance engagements on a cyclical basis. Monitoring should be performed in sufficient depth and by appropriate individuals. The absence of effective monitoring greatly impacts quality and is often a significant factor in whether firms comply with the practice review cycle.

CSQC 1 requires cyclical monitoring of completed assurance engagements to be completed by someone not involved in the engagement. A common challenge for sole practitioners or smaller partnerships is the lack of independence within the practice to perform cyclical monitoring activities. In these instances, practitioners may fulfil their cyclical monitoring obligations by engaging an external monitoring service provider. To have a positive effect on quality, it is essential that monitoring results are shared within the practice and that any corrective action is planned and executed in a timely manner. To achieve the benefits of monitoring, it is not enough to simply record the results. It is critical to develop and execute a plan of action.

[CPA Canada Handbook – Assurance; CSQC 1.48-.54]

NOTE: The Quality Control standards are changing. Please see Appendix 1 for more information.

V. COMPILATION ENGAGEMENTS

FALSE OR MISLEADING FINANCIAL STATEMENTS

When performing a compilation engagement, if there are matters which would cause the financial statements to be false or misleading additional information should be requested in order to complete the statements. For example, if there is documentation in the file which indicates a financial statement balance is misstated, then additional information must be obtained or the client asked to adjust the financial statements.

Another example indicating the financial statements may be false or misleading is if a note to the financial statements indicates they do not include all the disclosures required under ASPE. This statement implies the measurement and presentation is under ASPE, and unless the practitioner requests additional information to confirm this the financial statements may be false or misleading.

[CPA Canada Handbook – Assurance; 9200.20]

INDEPENDENCE THREAT NOT DISCLOSED IN THE NOTICE TO READER REPORT

When performing a compilation engagement, a firm is not subject to the independence requirements of CPA Alberta *Rules of Professional Conduct*, Rules 204.1 to 204.8. However, if independence matters are identified, the nature of the activity or relationship and the nature and extent of the interest shall be disclosed in the practitioner's written report accompanying the financial statements.

[CPA Alberta Rules of Professional Conduct, Rule 204.1 and 204.9]

NOTE: The compilation engagement standard is changing. Please see Appendix 1 for more information.

REMINDER FOR PRACTITIONERS – REQUEST FOR SPECIAL (NON-STANDARD) REPORTS

Clients often ask practitioners to sign certificates or otherwise provide verification of information through non-standard reports at the request of third parties, including financial institutions, government departments, or other organizations (for example, reports on a company's financial health or solvency). Before accepting such an engagement, practitioners are reminded of the requirements to perform appropriate procedures regarding the acceptance and continuance of client relationships and assurance engagements, which include establishing that the preconditions for the engagement are present. Preconditions for an attestation engagement include, among other factors, that the practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report.

Before accepting the engagement, practitioners must consider whether the form of their written report meets an appropriate standard within the *CPA Canada Handbook – Assurance*. Such standards and reports can be found in the Canadian Standards for Assurance Engagements (CSAE) as follows:

- CSAE 3000 - Attestation engagements other than audits or reviews of historical financial information;
- CSAE 3001 - Direct engagements;
- CSAE 3416 - Reporting on controls at a service organization relevant to user entities' internal control over financial reporting;
- CSAE 3530 - Attestation engagements to report on compliance;
- CSAE 3531 - Direct engagements to report on compliance;
- 9100 - Reports on the results of applying specified auditing procedures to financial information other than financial statements;
- 9110 - Agreed-upon procedures regarding internal control over financial reporting.

Understanding that the report may be essential to the client seeking financing, government assistance, or licensing or regulatory approval for a project, you may feel you should sign the requested report to provide the best service to your client. If the form of report requested does not meet the standards within the *CPA Canada Handbook – Assurance*, you should consider proposing an alternative that follows the standards and meets the client's needs. If the third party refuses to accept a report that is acceptable under the standards, you should assess whether the proposed engagement should be accepted. Whatever conclusion is made, documentation should include the decision and the factors considered in reaching decisions.

NEW AND EMERGING INDUSTRIES

Practitioners are increasingly engaging clients in new and emerging industries, including cryptocurrency and cannabis. These industries have unique risks that require careful consideration of the auditor's ability to develop and execute assurance procedures to obtain sufficient, appropriate audit evidence, including the potential for the use of experts or highly specialized training.

Practitioners who engage cryptocurrency clients may have little or no experience in this field. It is challenging to obtain evidence to support the existence, ownership and valuation of crypto assets, and it is likely that a controls-reliance approach is required. It is expected that valuation experts will be required in many of these engagements. Revenue generated through cryptocurrency transactions rely on blockchain technology, which is a new and complex electronic recording system. As a result, information technology experts may be necessary.

Cannabis entities can take many forms, including cultivation, production of medicinal products, or distribution and sales of related products. The most challenging issues arise with respect to the accounting for biological assets (the cannabis plants). As complex estimates are frequently used, expert valuation services are likely required. The regulatory aspects of this industry must also be considered during planning and throughout the engagement, as non-compliance with these regulations could have significant ramifications to the entity. This industry is also currently undergoing frequent mergers and acquisitions, which create unique accounting issues.

QUESTIONS

Should you have questions and/or require more information on any of the above, please contact 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, Member Engagement, at lbrownoff@cpaalberta.ca.

APPENDIX 1 – NEW STANDARDS RECENTLY EFFECTIVE OR NOT YET EFFECTIVE

CAS 540 – AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

At its October 2018 meeting, the Accounting and Assurance Standards Board (AASB) approved CAS 540, Auditing Accounting Estimates and Related Disclosures, including the related conforming amendments to other standards. CAS 540 is effective for audits of financial statements for periods beginning on or after December 15, 2019.

The revised CAS 540 incorporates changes to establish more robust requirements and appropriately detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures. Specifically, the revised CAS 540:

- Recognizes explicitly the spectrum of inherent risk and introduces the concept of inherent risk factors, including estimation uncertainty, complexity, subjectivity, and others;
- Enhances risk assessment procedures related to obtaining an understanding of the entity and its environment, including the entity's internal control;
- Introduces a separate assessment of inherent risk and control risk for accounting estimates;
- Introduces objectives-based work-effort requirements directed to methods (including specifically when complex modelling is involved), data and assumptions, to design and perform further audit procedures to respond to assessed risks of material misstatement;
- Enhances the "stand-back" requirement by adding an evaluation of the audit evidence obtained regarding the accounting estimates, including both corroborative and contradictory audit evidence;
- Enhances requirements to obtain audit evidence about whether the related disclosures are "reasonable"; and
- Includes a requirement to consider matters regarding accounting estimates when communicating with those charged with governance.

As a result of issuing revised CAS 540, requirements in the following standards have been amended to articulate more clearly the auditor's responsibilities regarding auditing accounting estimates and related disclosures:

- CAS 500, Audit Evidence, paragraph 7;
- CAS 700, Forming an Opinion and Reporting on Financial Statements, paragraph 13; and
- CAS 701, Communicating Key Audit Matters in the Independent Auditor's Report, paragraph 9.

QUALITY MANAGEMENT

On February 8, 2019, the International Auditing and Assurance Standards Board (IAASB) issued an Exposure Draft on quality management at the firm and engagement level. Accordingly, the Accounting and Assurance Standards Board (AASB) followed by issuing an Exposure Draft on quality management at the firm and engagement level in Canada in April 2019. The Canadian

Exposure Draft proposes to adopt the new international standard unchanged except for an amendment to the relevant independence and other ethical requirements to allow reference to Canadian requirements.

The Exposure Draft will result in:

- A new quality control standard at the firm level called the Canadian Standard on Quality Management 1 (CSQM 1) - Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements;
- A new standard for engagement quality reviews called the Canadian Standard on Quality Management 2 (CSQM 2) - Engagement Quality Reviews;
- Revisions to CAS 220 Quality Management for an Audit of Financial Statements; and
- Other related conforming and consequential amendments to standards.

The Exposure Draft introduces a new, risk-based approach to achieving quality at the firm level. CSQM 1 focuses on the practitioner identifying and responding to risks related to the quality of work performed, including establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses to these risks. By setting out the quality objectives and risks, and some required responses to the risks, firms will be able to adjust their system of quality control to suit the size, nature, and types of engagements that are performed. It is this ability to adjust the quality management system used by the firm that allows the standard to work for all sizes of firms. CSQM 1 also includes requirements to investigate the root causes of deficiencies so that appropriate action can be taken to effectively remediate deficiencies.

The scope of CSQM 1 will include all assurance engagements and related service engagements. Related service engagements include:

- Compilation engagements (Section 9200);
- Agreed-upon procedures engagements (Sections 9100 and 9110); and
- Engagements to report on supplementary matters arising from an audit or a review engagement (CSRS 4460).

CSQM 2, the engagement level standard, is a separate standard to allow for the scalability of the quality management standard. If there are no engagements that would require an engagement quality review in a firm, then there would be no requirement for the firm to consider CSQM 2. This new standard has been revised to be more specific about the engagement partner's responsibilities for leadership and project management, including assessing the competence of the engagement team. Requirements were also improved to recognize that engagement teams may be organized in a variety of ways, such as being located across different geographic regions and to consider the growing role of technology in a financial statement audit.

The revised CAS 220 will deal with the responsibilities of the engagement partner for quality management at the engagement level for an audit engagement. The importance of the public interest role of audits is emphasized together with the importance of the application of professional judgment and the exercise of professional skepticism. It sets out the roles and responsibilities of the engagement partner and acknowledges the use of electronic audit technology. To assist practitioners with the application of CAS 220, several application paragraphs have been included in the revised standard.

It is expected that the AASB will approve the new standard in the third quarter of 2020 and the standard will become effective approximately 18 months after approval.

Firms will need to prepare for the changes arising from the new quality management standard. Firms that only complete compilation engagements will need to ensure they are able to meet CSQM 1 by the time it becomes effective. The inclusion of related services engagements in CSQM 1 makes a significant change to the scope of the new standard in relation to the existing CSQC 1.

Further information can be obtained from:

https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/standards-other-than-cas/publications/audit-and-assurance-alert-quality-management

https://www.frascanada.ca/en/csqc

COMPILATION ENGAGEMENTS

The Accounting and Assurance Standards Board (AASB) concluded there is need for a new compilation engagement standard that would provide requirements and guidance on the performance of compilation engagements. The AASB staff has conducted research on examples of compiled financial statements and held consultations with bankers and other lenders, legal counsel, insurers, and practitioners. These consultations have assisted the AASB in their consideration of the new standard.

The proposed Canadian Standard on Related Services (CSRS) 4200 is intended to:

- Assist practitioners when performing compilation engagements;
- Clearly communicate through a revised compilation report the responsibilities of management and the practitioner; and
- Communicate the nature and scope of the engagement and whether an accounting framework has been used in the preparation of the financial statements.

Key issues that will be addressed by the proposed standard include:

- The identification of services which are within the scope of CSRS 4200;
- The level of documentation and extent of work required when performing a compilation engagement;
- The perception of the marketplace with respect to the level of assurance provided versus the assurance actually given; and
- The usefulness of financial statements when compiled using a generally accepted financial reporting framework versus a less rigorous framework or no framework.

The proposed scope of CSRS 4200 continues to exclude bookkeeping services; however, it will clarify the identification of bookkeeping services for the practitioner. The project was approved in September 2011 and an Exposure Draft was issued in September 2018. The final *Handbook* material was approved by the AASB in October 2019 and is expected to be issued in the *CPA Canada Handbook - Assurance* in February 2020.

The new standard will be effective for compiled financial information for periods ending on or after December 14, 2021. The AASB concluded that the revisions to the standard were significantly different from the proposals in the Exposure Draft but decided not to re-expose the changes as they do not significantly increase the practitioner's work effort and responsibility. The Board concluded re-exposure would not reveal any new information of which it had not already been made aware, and re-exposure would unnecessarily delay the implementation of the standard.

Further information can be obtained from:

https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/standards-other-than-cas/publications/audit-and-assurance-alert-compilation-engagements

https://www.frascanada.ca/en/other/projects/compilation-engagements

APPENDIX 2 – RESOURCES

In addition to the CPA Canada Handbooks on Accounting and Assurance (which can be found at Knotia.ca, www.knotia.ca, and are free for all CPA Canada members), there are many other resources available at no charge to Alberta CPAs.

- The CPA Canada website (www.cpacanada.ca/en/business-and-accounting-resources). The following resources are of particular relevance:
  - **Implementation tool for auditors: Dealing with ROMM due to fraud in revenue recognition** - Learn how to identify, assess and respond to the presumed risk of material misstatement (ROMM) due to fraud in revenue recognition;
  - **Implementation tool for auditors: Testing journal entries & responding to the risk of management override of controls** - Learn how to test the appropriateness of journal entries made in the preparation of financial statements as a response to the risks of management override of controls;
  - **Risk assessment of not-for-profit organizations (NFPOs) under Canadian Auditing Standards (CAS)** - Get an in-depth look at performing a risk assessment under CAS, as part of an audit of a not-for-profit organization (NFPO);
  - **Audit and assurance alert: Significant revisions to the joint policy statement** - Learn about significant changes in the revised Joint Policy Statement (JPS), which is effective for inquiry letters dated on or after December 1, 2016;
  - **Audit and assurance alert: Engagements to review historical financial statements (CSRE 2400)** - Learn about the new Canadian Standard on Review Engagements (CSRE) 2400, which is effective for reviews of financial statements for periods ending on or after December 14, 2017;
  - **Audit and assurance alert: Comparison between CSRE 2400 and the 8000 series** - Learn the key differences between the requirements in CSRE 2400, Engagements to Review Historical Financial Statements, and those in Section 8100, General Review Standards, and Section 8200, Public Accountant's Review of Financial Statements;
  - **Implementation tool: Canadian Standard for Related Services (CSRS) 4460** - Learn about the steps required in order to implement CSRS 4460 and report on a supplementary matter;
  - **Client briefing: Canadian Standard for Related Services (CSRS) 4460** - Help your client understand what they need to know and do when they receive third-party requests to provide supplementary information;
  - **Audit and assurance alert: CSRS 4460 — A new standard for reports on supplementary matters** - Learn about a new standard for reports on supplementary matters under Canadian Standards for Related Services (CSRS) 4460;
  - **Reporting-Implications-of-CAS-3rd-Ed-February-2019(1)** - CPA Canada has prepared this Guide to promote consistency in the form and content of auditor's reports by providing guidance with respect to commonly occurring circumstances; and
  - **Reporting-Implications-CSRE-2400-2nd-Ed-September-2018** - CPA Canada has prepared this Guide to promote consistency in the form and content of auditor's reports by providing guidance with respect to commonly occurring circumstances.

- The Financial Reporting & Assurance Standards Canada website (www.frascanada.ca). This website contains useful guidance on all the Canadian accounting frameworks and assurance standards, along with information on developing issues and discussions on proposed new standards.

APPENDIX 3 – COMMON DEFICIENCIES

FINANCIAL STATEMENTS

ASPE (References are to the *CPA Canada Handbook – Accounting Part II*)

- Debt due on demand, including related party loans, was inappropriately classified as long-term instead of current when there was no or inadequate support for the long-term classification *(1510.12-.13)*.

- Non-current asset included in current classification *(1510.03)*.

- Incomplete or missing disclosure of related party transactions *(3840.51)*.

- Inadequate or no disclosure of significant risks arising from financial instruments, including liquidity risk, credit risk, currency risk, interest rate risk, market risk, and other price risk. No disclosure of concentrations of these risks *(3856.53-.54).*

- Incomplete or missing disclosure of the carrying amount of assets pledged as collateral for liabilities and the terms and conditions relating to the pledge *(3856.44)*.

- Inadequate or no disclosure when following the income taxes payable method. Disclosure is required of:

    - A reconciliation of the income tax rate or expense related to income or loss for the period before discontinued operations to the statutory income tax rate or the dollar amount that would result from its application, including the nature and amount of each significant reconciling item;
    - 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 *(3465.88)*.

- Inadequate or no disclosures regarding inventories, including the accounting policy's cost formula, carrying amount of inventories in classifications appropriate to the entity, and the amount of inventories recognized as an expense during the period *(3031.35)*.

- For preferred shares issued in a tax planning arrangement which are redeemable at the option of the holder and classified as equity, not presented as a separate line item in the equity section on the face of the Balance Sheet, together with the total redemption amount for all such shares outstanding and the aggregate redemption amount for each class of such shares *(3856.23, .47(c))*.

- Non-cash items included in the Cash Flow Statement *(1540.41)*.

- Inadequate or no disclosure of share capital *(3240.20)*.

- Inadequate or no disclosure of the cash accounting policy *(1540.43-.44)*.

- No disclosure of the future minimum lease payments in aggregate and the next five years *(3065.77)*.

- Inadequate disclosure for bonds, debentures and similar securities, mortgages and other long-term debt, including the title or description of the liability, the interest rate, the maturity date, the amount outstanding, separated between principal and accrued interest, the currency in which the debt is payable if it is not repayable in the currency in which the entity measures items in its financial statements, and the repayment terms, including the existence of sinking fund, redemption and conversion provisions *(3856.43)*.

- Major categories of revenue recognized during the period were not disclosed separately by the entity *(1520.04, 3400.33)*.

Not-for-Profit Organizations (References are to the *CPA Canada Handbook – Accounting Part II and III*)

- Debt due on demand, including related party loans, was inappropriately classified as long-term instead of current when there was no or inadequate support for the long-term classification *(Part II 1510.12-.13 and Part III 4400.21)*.

- Incomplete or missing disclosure of related party transactions *(Part III 4460.07)*.

- Missing presentation on the Statement of Financial Position *(Part III 4400.19)*.

- Missing presentation on the Statement of Changes in Net Assets *(Part III 4400.41)*.

- Inadequate disclosure of the significant accounting policy for recognizing contributions *(Part III 4410.10, .21)*.

- Inadequate or no disclosure of the significant accounting policy for revenues other than revenues from contributions *(Part II 1505.03, 1505.06, 3400.31)*.

- No disclosure of the nature and amount of changes in deferred contributions for not-for-profits following the deferral method *(Part III 4400.26)*.

- No disclosure of the basis of presentation *(Part III 1401.17)*.

- No description of the purpose of each fund *(Part III 4400.06)*.

- No description of a not-for-profit organization's purpose, its intended community of service, its status under income tax legislation and its legal form *(Part III 4400.04)*.

- Incomplete or missing disclosure of fundraising and general support expenses allocated to other functions *(Part III 4470.08)*.

AUDIT ENGAGEMENTS

(References are to the *CPA Canada Handbook – Assurance*)

- The auditor did not document the design and performance of substantive audit procedures for each material class of transactions, account balances, and disclosures *(CAS 330.18, CAS 500.6).*

- The auditor did not document the design and performance of audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements *(CAS 240.33, CAS 330.20).*

- When the auditor used audit sampling to provide a reasonable basis to draw conclusions about the population from which the sample was selected, the documentation did not reflect how the auditor met the requirements of the standard. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level and select items for the sample in such a way that each sampling unit in the population has a chance of selection. The auditor shall perform audit procedures on each item selected for the sample, with a replacement item selected if the procedure is not applicable to the selected item, or treat it either as a misstatement in a test of detail if the auditor is unable to apply the designed audit procedure on it (and project the misstatements found to the population) or as a deviation in a control test. The auditor shall then evaluate the results of the sample and whether it provided a reasonable basis for conclusions about the population that had been tested *(CAS 530.7-.11, .14-.15).*

- The auditor did not obtain an understanding of the control environment, control activities relevant to the audi,t and an understanding of the information systems, including the related business processes, relevant to financial reporting *(CAS 315.14, .18, .20).*

- When obtaining an understanding of controls that are relevant to the audit, the auditor did not evaluate the design of those controls and determine whether they were implemented by performing procedures in addition to inquiry of the entity's personnel *(CAS 315.13).*

- The auditor did not make inquiries of management regarding management's assessment of the risk that the financial statements might be materially misstated due to fraud, and their knowledge of any actual, suspected or alleged fraud affecting entity and document management's response *(CAS 240.17-.19).*

- As part of the risk assessment procedures, there was no documentation of discussion with those charged with governance regarding an understanding of how those charged with governance exercise oversight of management's processes and internal controls for identifying and responding to the risks of fraud and their knowledge of any actual, suspected or alleged fraud, including the response *(CAS 240.21-.22).*

- The auditor did not identify and assess the risks of material misstatement at the financial statement level and/or at the assertion level for classes of transactions, account balances, and/or disclosures *(CAS 315.25).*

- The auditor did not document the reasons for concluding that the presumption of a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement *(CAS 240.26-.27).*

- Analytical procedures were not performed as part of the risk assessment procedures to obtain an understanding of the entity and its environment *(CAS 315.6).*

- Subsequent event procedures not completed or documented up to the date of the auditor's report *(CAS 560.6-.8).*

REVIEW ENGAGEMENTS

(References are to the *CPA Canada Handbook – Assurance*)

- Materiality was not determined for the financial statements as a whole and/or applied in designing the procedures and in evaluating the results obtained from those procedures *(CSRE 2400.41).*

- An understanding of the client was not documented, including:
  - Relevant industry, regulatory, and other external factors including the applicable financial reporting framework;
  - The nature of the entity including:
    - Its operations;
    - Its ownership and governance structure;
    - The types of investments that the entity is making and plans to make;
    - The way that the entity is structured and how it is financed; and
    - The entity's objectives and strategies;
  - The entity's accounting systems and accounting records; and
  - The entity's selection and application of accounting policies. *(CSRE 2400.44).*

- The areas in the financial statements where material misstatements are likely to arise were not identified *(CSRE 2400.45)*.

- The date of the written representations was after the date of the practitioner's report *(CSRE 2400.73)*.

- The written representation from management did not include:

- Whether management believes the effects of uncorrected misstatements are immaterial, individually or in the aggregate, to the financial statements as a whole, and a summary of such items was not included or attached to the written representation;
    - That management has disclosed to the practitioner significant facts relating to any frauds or suspected frauds known to management that may have affected the entity; and
    - That management has disclosed to the practitioner all information relevant to use of the going concern assumption in the financial statements *(CSRE 2400.68-.70)*.

- The practitioner's enquiries of management did not include the existence of any actual, suspected or alleged fraud or illegal acts affecting the entity *(CSRE 2400.47(d))*.

COMPILATION ENGAGEMENTS

- There was no documentation that the practitioner had considered whether there were any matters that would impair his/her independence. If matters are identified, the nature of the activity or relationship and the nature and extent of the interest shall be disclosed in the practitioner's written report accompanying the financial statements *(CPA Alberta Rules of Professional Conduct, Rule 204.09).*

- The practitioner did not document in the file that an understanding and agreement with the client had been reached as to the services to be provided *(CPA Canada Handbook – Assurance; 9200.16).*

CANADIAN STANDARDS ON QUALITY ASSURANCE

(References are to the *CPA Canada Handbook – Assurance*)

- The firm did not establish a monitoring process that included, on a cyclical basis, inspection of at least one completed engagement for each engagement partner *(CSQC 1.48).*

- The firm did not comply with its documented cyclical monitoring process by having one completed engagement for each partner inspected within the established cycle *(CSQC 1.48).*

- The firm did not perform an ongoing consideration and evaluation of the firm's system of quality control *(CSQC 1.48).*