

This is a compilation and synthesis of recent practice inspection findings by the Institutes of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Quebec. They are publicly available from their web sites.

Practice Inspection Findings 2013

Recent reports were not found for any of the Atlantic Provinces but this does not mean they do not exist

The provinces that make this information available do so to inform their members of common deficiencies, so that their provincial members can learn from them, and to protect the public interest.

It is in this spirit we have created this document for our Canadian colleagues and make it freely available to them.

We present these findings by area.

DEFICIENCIES IN PRESENTATION STANDARDS

- Financial Statement Presentation Deficiencies
- International Financial Reporting Standards Deficiencies
- Accounting Standards for Private Enterprises Deficiencies
- Accounting Standards For Not For Profit Entities Deficiencies
- Public Sector Accounting Standards Deficiencies

DEFICIENCIES IN ENGAGEMENT PERFORMANCE STANDARDS

- Deficiencies in Quality Control
- Audit Engagement Deficiencies
- Review Engagement Deficiencies
- Compilation Engagement Deficiencies
- Tax Engagement Deficiencies

COPIED DIRECTLY FROM THE QUEBEC REPORT

- Departures From Harmonized Code Of Ethics And The Chartered Professional Accountants Act
- Likely Root Causes Of Deficiencies

We hope you find this useful.

For comments, suggestions etc, contact John B Voorpostel CPA,CA
taxboard@gmail.com



Financial Statement Presentation Deficiencies

- **Revenue recognition policies** were not adequately disclosed for all significant revenue streams.
- Missing policy indicating the cost basis and valuation **basis of inventory**.
- Incomplete and incorrect disclosures for **contracts in progress**.
- Missing **carrying amount of any assets pledged as collateral** for liabilities.
- **Government remittances** such as federal and provincial sales taxes, payroll taxes, health taxes, and workers' safety insurance premiums were not disclosed separately
- **Debt due on demand**, including related party debt, is often inappropriately classified as long-term debt.
- Disclosure of **terms and conditions of preference shares**.
- Disclosure of **shares issued in a qualifying tax planning arrangement** and the determination of all issued preference shares as either a liability or equity.
- **Basis of Presentation notes** were not included in Basis of Accounting notes.
- Disclosures of **related party transactions** are missing the description of the relationship, transactions, terms and conditions, and the measurement basis.
- **Financial instrument note disclosure** is often inadequate, failing to identify all of the financial instruments of the entity and insufficient discussion of fair values and interest rate and credit risk.
- **Tax note disclosures** are incomplete or missing, both when future income taxes and taxes payable methods are being applied.
- Disclosure of the nature and extent of **financial instruments, and credit risk, interest rate risk, currency risk and fair value**, was insufficient were it was considered a significant risk for the entity.
- For ASPE financial statements, the **accounting policy for Income Taxes** is not always disclosed.
- **Future minimum lease payments in the aggregate and for each of the five succeeding years** under operating leases were not disclosed.
- There were instances where that was **no cash flow statement presented**.

International Financial Reporting Standards Deficiencies

- Insufficient disclosure of **related party transactions** terms and conditions, nature and extent of transactions, description of relationship, and measurement basis is often inadequate.
- Insufficient disclosure of **key management personnel compensation**.
- Insufficient disclosure of **market risks and sensitivity analysis**.
- Insufficient disclosure of **date of financial statement authorization** and who gave that authorization.
- Insufficient disclosure on Statement of Cash Flows of **investing and financing transactions that do not require the use of cash or cash equivalents**.
- Insufficient disclosure of **operating segments**.

Accounting Standards for Private Enterprises Deficiencies

- Insufficient disclosure of **related party transactions** terms and conditions, nature and extent of transactions, description of relationship, and measurement basis.
- Inappropriate disclosure of **debt due on demand**, including related party debt without set terms of repayment, which was often inappropriately classified as long-term debt.
- No separate disclosure of **government remittances** such as federal and provincial sales taxes, payroll taxes, health taxes, and workers' safety insurance premiums.
- **Tax note disclosures** are incomplete or missing, both when future income taxes and taxes payable methods are being applied.
- Insufficient disclosure of the **revenue recognition policy**, which is required for all entities and all material revenue streams.
- Disclosure of issued share capital **shares issued in a qualifying tax planning arrangement** and the determination of all issued **preference shares as either a liability or equity** based on facts existing at the balance sheet date.
- **Basis of Presentation notes** were not included in Basis of Accounting notes
- There were instances where that was **no cash flow statement presented**.

Accounting Standards For Not For Profit Entities Deficiencies

- Insufficient disclosure of the **revenue recognition policy for contributions** as well as revenue from other material revenue streams
- Lack of inclusion of a **Statement of Cash Flows**.
- Incomplete disclosure of **first time adoption of Accounting Standards For Not For Profit Entities**

Public Sector Accounting Standards Deficiencies

- Lack of disclosure of **budgeted amounts** on the Statement of Operations and Statement of Change in Net Debt in accordance.
- Inappropriate presentation of **net debt and changes in net debt**.

Deficiencies in Quality Control

- Firms are **not assessing whether an Engagement Quality Control Review is necessary** for their assurance engagements, as required by their quality control manual.
- Firms are **not fulfilling their cyclical completed file monitoring requirements**, as required by the Canadian Standards on Quality Control (CSQC-1) and as outlined in their quality control manual.
- Firms are **not updating their quality control manual for CSQC-1**.
- Firms are not annually **evaluating the firm 's system of quality control**, or, if it has been done, **documentation and communication of changes is inadequate**.

Audit Engagement Deficiencies

Note that all engagements are now subject to Canadian Auditing Standards (CAS)

Planning Deficiencies

1. Risk assessment

- **Insufficient assessment and documentation of risk** of material misstatement, whether due to fraud or error, at both the financial statement and assertion level, and lack of clear linkages between the risk assessment and the nature, timing and extent of the auditor's further audit procedures and the actual work performed on classes of transactions, account balances and disclosures

- **Insufficient assessment of inherent risk and link to, and impact on, the design of tests** to ensure the auditor obtains appropriate evidence that relevant, relied upon internal controls are operating effectively.

- **Insufficient assessment and documentation of fraud risks factors and their impact on the audit plan** including:

The required ordinary presumption of risk of fraud in revenue recognition and a consideration of which types of revenue, revenue transactions or assertions may give rise to such risks.

Where the auditor concluded an ordinary presumption of fraud risk was not applicable, the reasons for such conclusion were insufficiently documented.

Insufficient documentation of discussions with management and those charged with overall corporate governance regarding their assessment of fraud risks and how they address them, and whether they are aware of any actual, suspected or alleged fraud.

Insufficient evidence of a clear link between results of the fraud risk assessment and its impact on the audit plan.

Insufficient documentation of engagement team meeting attendees and their discussions related to all risks and where the entity's financial statements may be susceptible to material misstatement due to fraud or error.

- **Insufficient use of analytical review procedures** to uncover unusual or unexpected relationships on balance sheet and income statement as part of the risk assessment process and to obtain an understanding of the entity and its environment.

2. Assessment of internal controls

- **Insufficient documentation of auditor's planned reliance on internal controls** and their preliminary walk through to ensure these controls exist

- **Insufficient documentation of the auditor's understanding of the entity and its environment,**

including control environment and risk and that understanding's linkage the auditor's assessment of the risk of material misstatement in the financial statements.

- **Insufficient documentation of auditor's determination of whether or not the internal controls are appropriately designed** and have been implemented

- **Insufficient documentation that the auditor understands the entity's information systems and business processes** that are relevant to financial reporting, as well as the entity's processes for monitoring these internal controls

3 Materiality

- **Insufficient documentation of preliminary analytical procedures** on specific classes of transactions and account balances.

- **Limiting the calculation of materiality to overall materiality and not considering performance materiality** used in the determination of the nature, extent and timing of audit procedures (and its calculation of a cushion to allow for potential misstatements that may not be uncovered) to be used for the audit of particular classes of transactions, account balances and disclosures.

- **Deficiencies in the documentation** of overall and performance materiality

4 Auditor's understanding of the entity and its environment

- **Insufficient documentation of the auditor's understanding of:**

The control environment.

The entity's risk assessment process.

Information systems and business processes relevant to financial reporting and communication.

Control activities relevant to the audit.

Major activities used to monitor internal control over financial reporting

How the entity initiates remedial actions with respect to deficiencies in its controls.

Financial reporting processes used to prepare financial statements.

Entity's response to risks arising from information technology (IT).

Industry, regulatory and other factors.

Nature of the entity (operations, ownership, governance and financial structure).

Selection and application of appropriate accounting policies.

Objectives, strategies and business risks.

Financial performance measurement and review.

Compliance with laws and regulations.

5 Related parties

- **Lack of adherence to explicit requirements for the risk assessment** and other procedures that the auditor shall perform with respect to related party transactions including:

Enquiry 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.

The automatic deeming of any related party transactions outside the normal course of business as a significant risk and its effect on audit planning.

Performance Deficiencies

1 Substantive procedures

- **Insufficient documentation of substantive audit procedures** in the areas of analytic procedures, audit sampling, journal entry testing, subsequent events, and the testing of revenues, income statement accounts and payrolls .
- **Substantive audit procedures performed did not comply with various CAS recommendations** relating to subsequent events review, test of journal entries for unauthorized entries and management override, and management estimates.

2. Procedures to uncover fraud

- Auditor **did not incorporate element of unpredictability** in design of and selection of nature, extent and timing of audit testing.

3 Subsequent events procedures

- **Insufficient documentation of subsequent events procedures** required to performed up to the date of the audit report, including evidence that the appropriate representative of the audit client had taken responsibility for the completed financial statements.

4 Going concern assessment

- **Lack of and insufficient documentation of management's assessment** of the entity's ability to continue as a going concern.

5 Evaluation of the requirement for an engagement quality control review (EQCR)

- An **evaluation of the EQCR requirement was not done** or not done according to requirements and criteria set out in the firm's quality control manual.

6 Audit completion date

- **Insufficient documentation of the completion of a final audit file** within 60 days of the audit report date, including evidence of partner taking responsibility that all appropriate reviews, discussions and consultations had taken place

Communication Deficiencies

1 Engagement and representation letters

- Engagement and representation letters **omitted required inclusions**
- **Inappropriate dating and signing dates** on engagement letters and management representation letters.

2 Communications with those charged with governance

- **Deficiencies in the form, timing and general content of communications** with management and those charged with governance including:

An overview of the planned scope and timing of the audit

The auditor's responsibilities in relation to the financial statement audit

The written representations that the auditor is requesting from management

Significant audit deficiencies found during the engagement that were communicated to management.

Uncorrected misstatements and their effect, individually or in the aggregate, on the auditor's report.

The effect of uncorrected misstatements related to prior periods

The auditor's views about significant qualitative aspects of the entity's accounting policies.

- **Lack of documentation of oral communication with client staff, management and those charged with governance** including reasons for discussion, substance of discussion, conclusions reached, and the specific identities of individuals spoken to

3 Format and date of auditor's report

- **Non compliance with CAS 700 requirements** detailing format requirements
- **Insufficient documentation supporting the date of the auditor's report** including evidence that the financial statements were fully prepared that those with the recognized authority had asserted they had taken responsibility for those financial statements.
- **Lack of documentation that subsequent events procedures were performed** up to the date of the report
- **Management representation letters were not dated** as close to practicable to the date of the report
- **Incomplete modifications to the report** where the auditor expressed a qualified or adverse opinion

4 Financial reporting framework

- **Lack of reference in the audit report to the exact financial reporting framework** (ie, IFRS, ASPE, NFPO, etc) that is being applied.

Review Engagement Deficiencies

- The **documentation of enquiry, discussions and analytical procedures** performed to establish the plausibility of financial statement balances were weak in the following areas:

Inter-relationship/comparison of revenues, expenses, gross margin, operating ratios and balance sheet items.

The client's cut-off procedures over cash, revenue/receivables and expenses/payables and assessment as to the adequacy of such procedures and in cases where such procedures are determined to be inadequate, the additional procedures performed by the practitioner.

Description of client inventory count procedures, including date, instructions, staff used, supervision, identification of obsolete or consigned inventory, and an assessment of valuation and their costing consistency.

Identifying contingencies, commitments and subsequent events

GST\HST plausibility of year end balances and the amounts paid/received during the year

Lack of specific analytic review and focus on material financial statement items

- **Lack of evidence that even if there were no unusual amounts, variances or trends**, that the practitioner gave such items due consideration.
- **Lack of evidence of inquiry, analytical procedures and discussion** to establish overall plausibility
- **Engagement letters and representation letters** did not include all the matters required by the applicable recommendations of the CICA Handbook.
- Inadequate documentation on **assessment of independence & client acceptance and continuance**.
- Review Engagement Reports were found that were **dated prior to management approving the statements**.
- **Review engagement report deficiencies** when corresponding figures neither audited nor reviewed on transition to a different accounting framework
- **Omission of required inclusions in engagement and representation letters** omitting required inclusions.
- **Date of file completion and review report engagement report** was not documented
- **No indication of approval of the financial statements** by a recognized authority
- **Insufficient evidence of appropriate partner reviews** before the date of the report

Compilation Engagement Deficiencies

- The file does not include documentation of the practitioner's **assessment of independence**.
- **Notice to Reader wording** does not comply with requirements.
- Missing and unsigned **engagement letters**

Tax Engagement Deficiencies

- Engagement letters are recommended for all engagements, including tax engagements. The engagement letter should be obtained prior to the commencement of the engagement, and updated at least every three years.
- For T1s, written evidence of client instruction in respect of foreign assets and income disclosure is often missing. This could be addressed by adding a paragraph to the engagement or transmittal letter to confirm that foreign assets and income have been disclosed.

The Following Was Copied Directly From The Quebec Report

The five most common departures from the Code of Ethics of Chartered Professionals Accountants and the Harmonized Rules of Professional Conduct for Chartered Professional Accountants in Canada are as follows:

Breach of section 21 of the Code of Ethics which specifies that a member who performs a contract, in whole or in part, in the practice of his profession, assumes full personal civil liability arising therefrom, and is forbidden to include in such contract any clause to the effect of directly or indirectly, fully or partially, excluding this liability.

Breach of section 204.8 of the Harmonized Rules, which specifies that a member engaged in the practice of public accounting who provides a service not subject to the requirements of Rules 204.1 to 204.7 shall disclose any activity, interest or relationship which, in respect of the engagement, that would be seen by a reasonable observer to impair the member's or firm's independence such that the professional judgment or objectivity of the member, firm or member of the firm would appear to be impaired.

Breach of section 204.4.23 of the Harmonized Rules, which specifies that a member who performs an assurance engagement shall obtain the approval of management of the entity for the journal entry he had prepared.

Breach of section 48 of the Code of Ethics, which specifies that a member is bound by professional secrecy and cannot classify client files in an area where confidentiality could be compromised.

Breach of section 204.2 of the Harmonized Rules, which specifies that a member shall, in respect of an assurance engagement, identify threats to independence, evaluate the significance of those threats and, if the threats are other than clearly insignificant, identify and apply safeguards to reduce the threats to an acceptable level.

The two most common departures from the Chartered Professionals Accountants Act were the following:

Breach of section 13 which specifies that no one (individuals, partnerships and joint-stock companies) may use the "CA", "CGA", "CMA" or "public accountant" title. The dual designation (CPA, CA; CPA, CGA or CPA, CMA) must be used by all individuals; however, its use in the firm's name is not permitted.

Breach of section 7, which specifies that chartered professional accountants who hold a public accountancy permit and engage in the professional activity described in the third paragraph of section 4, except the performance of compilation engagements not intended exclusively for internal management purposes, must use the title "auditor". The title of auditor must be preceded by the title "chartered professional accountant" or the abbreviations or initials that refer to that title.

Likely root causes of deficiencies identified

Deficiencies identified in inspection reports lead to questions as to their probable causes. Here are some of the possible root causes reflected in the analysis:

- The lack of competent personnel in auditing or a specific sector to perform mandates, and the retention of key employees, are real challenges for firms of all sizes.
- There are significant weaknesses in assurance files that were neither supervised nor reviewed by an engagement partner. Firms bypass the quality control standards, which reduces the quality of file documentation. Some partners spend too much time managing clients to the detriment of supervising employees and reviewing their work.
- Inspections brought to light a lack of continuity and consistency in work methodology and the financial statements. It should be noted that partners in firms are evaluated collectively, not individually, by the Committee. Often, no one has been appointed quality control reviewer, which leads to gaps in the quality of the various partners' files.
- There is downward pressure on fees. To be profitable, practitioners sometimes reduce the quantity of work to the detriment of quality.
- Practitioners neglect to maintain or upgrade their knowledge and skills in areas in which they practice.
- Practitioners sometimes have difficulty assimilating the concepts they learn about in training sessions and mistakenly interpret and apply the standards. For example, practitioners often fall into the trap of not applying auditing procedures when engagements are simple, have a low risk, or even when a financial statement item has been analyzed as being low risk. Caution must be exercised! Applying a risk-based audit approach is always required even if the client's structure is simple or the engagement is low risk. In addition, it is important to remember that, in an audit, substantive procedures must mandatorily be applied to revenues, purchases, salaries and other expenses.
- Practitioners sometimes accept engagements for which they do not have all the necessary knowledge, mainly as concerns specific procedures to implement for the issue of different audit reports (for example, an audit of a subsidized daycare, a cooperative, a municipality, etc.)
- Practitioners who have a long-standing understanding of their clients tend to reduce the amount of documentation in the files over the years. They neglect to document what is obvious to them. This often results in superficial documentation or documentation that contains no information on review procedures relating to analyses of significant variations in income statement items like revenues, gross margins and expenses.
- Audit team members do not sufficiently apply professional skepticism. For example, in certain cases, it was noted that no steps had been taken to validate data received from management regarding accounting estimates, provisions or other items. This can be the result of a too close relationship being developed over time between the practitioner and the client.
- Even though procedures have been implemented, if they are not documented in the file, the Committee cannot evaluate them.