CHARTERED PROFESSIONAL ACCOUNTANTS MANITOBA

FOCUS ON PRACTICE INSPECTION

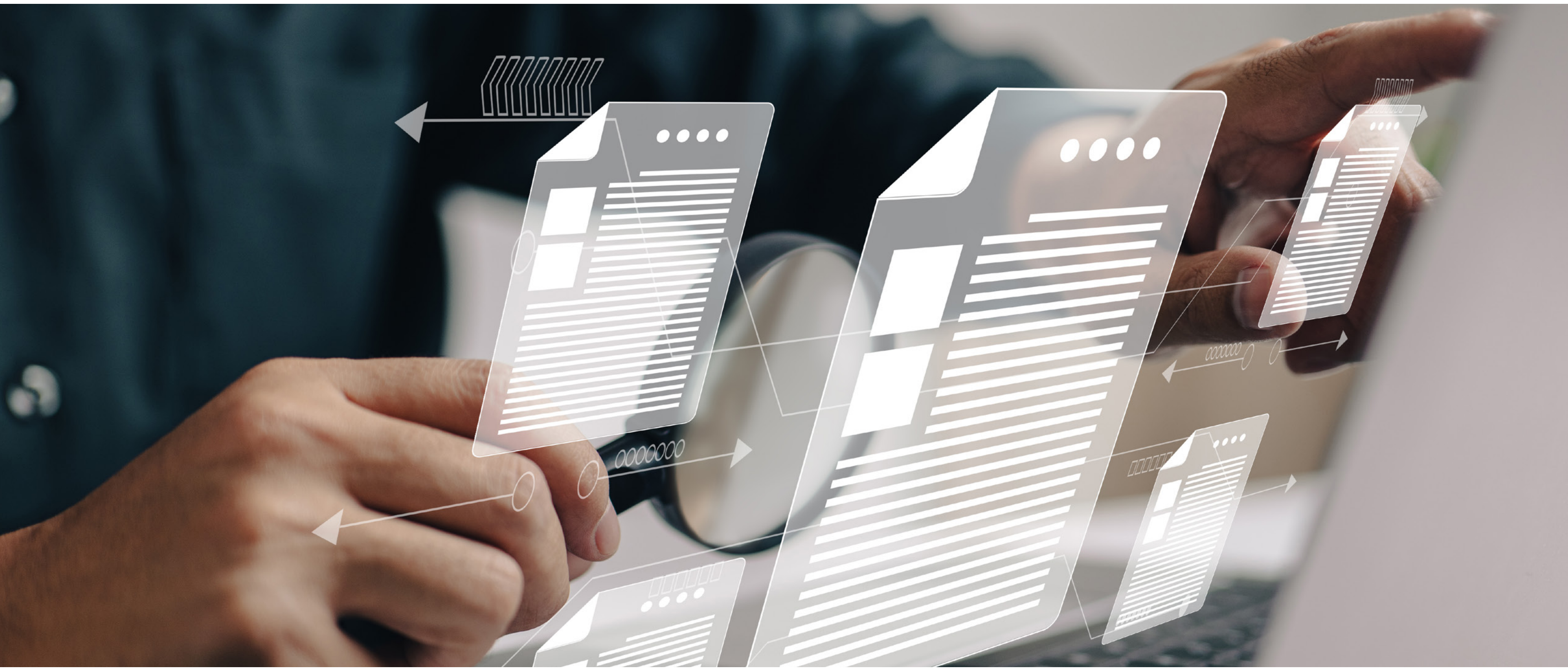
2023

INTRODUCTION

As the governing body of a self-regulating profession, CPA Manitoba contributes to the protection of the public by promoting the highest standards of integrity and expertise to our members. Practice inspection is a key component of CPA Manitoba's overall regulatory process. We assess practitioners' adherence to professional standards, thereby contributing to users' confidence in the integrity of financial information. We achieve this by assessing quality management and inspecting assurance and compilation engagements. We also provide an educational experience to help practitioners improve their professional standards where necessary.

As our professional and regulatory landscapes continue to change, we must 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, we highlight the results of inspections as well as observations and suggestions for improvement that we believe will best assist practitioners in performing high-quality engagements.



BACKGROUND

The Practice Inspection Committee ("committee") reviews annual inspection results to identify areas where adherence to standards requires improvement and issues this communication to provide guidance to practitioners. The committee is comprised of nine members, including the committee chair, and is appointed by the CPA Manitoba Board. The committee is representative of CPA Manitoba's membership by geographic location and practices of all sizes.

The inspection cycle is risk adjusted with all practising offices being inspected at least once in the cycle. The committee assesses inspection reports together with any comments received from the practising office and determines the outcome of the inspection which may be as follows:

- the inspection is complete, and no further action is required;
- a specified course of action needs to be undertaken in order to deem the inspection complete. The provision of a suitable action plan may be sufficient to satisfy the committee that the appropriate steps are being taken;
- a full or partial re-inspection is required. The committee may also recommend certain specified actions, including professional development courses, it deems relevant to addressing the reportable deficiencies raised; or
- a referral is made to the Complaints Investigation Committee (CIC).

The factors considered by the committee in determining the action to be taken following an inspection may include, but are not limited to:

- the degree to which the requirements of the National Practice Inspection Program have been met;
- the nature and severity of identified deficiencies;
- the cooperation of the practising office;
- the public interest; and
- upon re-inspection, the results of the previous inspection of the practising office and the degree to which the practising office addressed identified deficiencies.

Referral to the CIC occurs when the committee deems that the appropriate remedial action has not been effective, or that a referral is required in the public interest. Other matters resulting in a referral include a breach of the Code of Professional Conduct and/or an engagement they do not have the permit for which to perform.

This past year, we inspected 60 practising offices, approximately 72% of which did not require further action. The remaining practising offices were subject to remedial action, ranging from re-inspection to referral to the CIC.

INSPECTION OBSERVATIONS

Below are critical observations arising from practice inspections. These reflect the common material misstatements identified and, with respect to engagement performance, the more significant deficiencies which may have a greater impact on the quality of work performed.

It is important to note that Practice Inspection does not set standards. Professional standards are set out in the *CPA Canada Handbooks* and CPA Manitoba's Bylaws, Regulations and Code of Professional Conduct.

FINANCIAL STATEMENT PRESENTATION

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

When such deficiencies are identified during the practice inspection process, practitioners are encouraged to carefully consider not only the actions the firm will take on a go-forward basis, but also consider 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. Practitioners are reminded that loan repayments being accepted over an amortization period do not necessarily indicate long-term debt; the end of the amortization period is not the same as a maturity date. 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 include inquiring 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 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, partial classification as long-term may be appropriate.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 1510.12-.13; 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 inquiring with the entity.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 1510.03; 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 or accounts receivable with repayment terms extending beyond one year. 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. An example 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 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 inquiring with the entity.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 1510.03-.07; CPA CANADA HANDBOOK – ACCOUNTING PART III; 4400.21]

RELATED PARTY TRANSACTIONS

The measurement and disclosure of related party transactions continues to be a common deficiency encountered in practice inspection. Missing or incomplete disclosure includes: description of the relationship between the parties; terms and conditions of balances due to or from; recognized amount of transactions classified by financial statement category; description of transactions including those for which no amount has been recognized and measurement basis.

When performing audit or review engagements, practitioners must perform and document their procedures, identify all related party transactions and support the measurement basis used.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 3840.51 (disclosure) and 3840.07A-.44; CPA CANADA HANDBOOK – ACCOUNTING PART III; 4460]

RETRACTABLE OR MANDATORILY REDEEMABLE SHARES ISSUED IN A TAX PLANNING ARRANGEMENT

Retractable or mandatorily redeemable shares issued in a tax planning arrangement are often incorrectly presented as equity when either control was not retained by the shareholder receiving shares in the arrangement, or consideration was received by the enterprises when issuing the shares, or the holder of the shares has the contractual right to require the enterprise to redeem the shares on a fixed or determinable date or within a fixed or determinable period. The amendments to 3856 regarding such shares were effective for fiscal years beginning on or after January 1, 2021.

When performing audit or review engagements, practitioners must perform and document their procedures to demonstrate that the shares meet the requirements for equity presentation when classified as such.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 3856.23]

OTHER MISSING DISCLOSURES

- Inadequate or missing disclosure of the significant risks arising from financial instruments (Part II 3856.53, 3856.A66)
    - Credit risk;
    - Currency risk;
    - Interest rate risk;
    - Liquidity risk;
    - Market risk;
    - Other price risk.

- Inadequate or missing disclosure of financial liabilities that are secured (Part II 3856.44) along with the following items:
    - The carrying amount of any assets pledged as collateral for liabilities;
    - The terms and conditions relating to the pledge.

- Inadequate or missing disclosure of the carrying amounts for the following categories of financial instruments (Part II 3856.38):
    - Financial assets measured at amortized cost;
    - Financial assets measured at fair value;
    - Investments in equity instruments measured at cost less any reduction for impairment.

- Inadequate or missing disclosures regarding inventories (Part II 3031.35) including:
    - The accounting policies adopted in measuring inventories, including the cost formula;
    - The total carrying amount of inventories in classifications appropriate to the entity;
    - The amount of inventories recognized as an expense during the period.

- Inadequate or missing disclosure of the following when following the income taxes payable method (Part II 3465.88):
    - 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 portion of income tax expense (benefit) related to transactions charged (or credited) to equity.

REVENUE RECOGNITION ON LONG-TERM CONTRACTS

While the recognition and measurement standards have not changed, the additional disclosure requirements for enterprises using the percentage of completion method became effective for fiscal years beginning on or after January 1, 2022.

When performing audit or review engagements, practitioners must perform and document their procedures to demonstrate that the revenue recognition policy followed for long-term contracts is in accordance with the standards. This can be a complex technical area and practitioners with such clients should be very familiar with the requirements of 3400, including the appendix and consider taking professional development specific to this standard.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 3400.32A]

RESTRICTED CONTRIBUTIONS

When restricted contributions have been received and the organization follows the deferral method (or has received a restricted contribution in the general fund under the restricted fund method), it was not recorded correctly based on the restriction.

[CPA CANADA HANDBOOK – ACCOUNTING PART III; 4410.31, .33-34, .38-40, .45)]

AGRICULTURE

The new section on agriculture became effective for fiscal years beginning on or after January 1, 2022. While practice inspection had not encountered many inspections with clients who had been required to adopt this section, practitioners with such clients should be aware of the new requirements and educate themselves accordingly.

[CPA CANADA HANDBOOK – ACCOUNTING PART II; 3041)]

AUDIT ENGAGEMENTS

Documentation of risk assessment procedures with respect to obtaining an understanding of the entity and its environment, and the applicable financial reporting framework and the documentation of the entity's system of internal control did not include the entity's information system and communication relevant to the preparation of the financial statements. Revised CAS 315 became effective for periods beginning on or after December 13, 2021. (CAS 315 paragraphs 19-27)

When assessing the risk of material misstatement due to fraud, the auditor did not document management's knowledge of actual, suspected or alleged fraud, or management's process for identifying and responding to fraud and error. (CAS 240 paragraph 18-19). Unless all of those charged with governance are involved with managing the entity, the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes and make inquiries of those charged with governance to determine whether they have any knowledge of actual, suspected or alleged fraud. (CAS 240 paragraph 20-21)

The auditor did not conduct a team planning meeting to discuss how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The engagement partner must be in attendance. (CAS 240 paragraphs 16, 45; CAS 315 paragraph 17)

The auditor did not perform analytical procedures to identify whether there were unusual or unexpected relationships in accounts that may indicate risk of material misstatements. (CAS 240 paragraph 23)

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 paragraph 18; CAS 500 paragraph 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 paragraph 33; CAS 330 paragraph 20)

The auditor did not adequately identify accounting estimates and develop audit procedures to address risks associated with those estimates as required by CAS 540.

The written representation from management was not appropriately dated as near as practicable to the date of the auditor's report. Written representations are necessary audit evidence; as such, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable, but not after, the date of the auditor's report on the financial statements. (CAS 580 paragraph 14)

When the auditor identified misstatements, they did not evaluate whether the misstatements were indicative of fraud. When the auditor has reason to believe the misstatements may be the result of fraud that management is involved in, the auditor must reevaluate the assessment of the risk of material misstatement, and the impacts on the nature, timing and extent of audit procedures to respond to the assessed risks. (CAS 240 paragraphs 36-37)

The auditor did not assemble the final audit file on a timely basis after the date of the auditor's report. (CAS 230 paragraph 14)

REVIEW ENGAGEMENTS

Understanding the Accounting Systems and Accounting Records

Understanding the accounting systems and records used by an entity is vital to identifying areas where a material misstatement is likely to arise. This allows the practitioner to focus analysis and inquiry on these areas. We identified instances where this documentation could be improved. For example, documentation often consisted of brief accounting system notes which were superficial and did not result in a meaningful analysis. The understanding should be obtained within the context of the applicable financial reporting framework such as Canadian accounting standards for private enterprises or Part II of the *Handbook*. For example, if the entity is in the construction business, the understanding should include details regarding how revenue is recognized on long-term contracts with reference to the requirements of Part II 3400. If the entity is in farming, the understanding should address the requirements of the new agriculture standard in Part II 3041.

[CSRE 2400 paragraphs 43 and 44 practitioner's understanding]

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. Without understanding the requirements of the applicable financial reporting framework and those standards applicable to the business of the entity, it will be difficult for the practitioner to identify areas where material misstatements are likely to arise and design and perform appropriate procedures to obtain limited assurance.

[CSRE 2400 paragraph 45 identifying areas in the financial statements where material misstatements are likely to arise; CSRE 2400 paragraph 46 designing and performing procedures]

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, including inquiries regarding significant estimates, related parties, the existence of fraud or illegal acts, going concern considerations and subsequent events. 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. Inspections have identified that this analysis is sometimes performed as a perfunctory exercise. For example, we often found one-word responses to inquiries that clearly required a more detailed response. The inquiries listed in paragraph 47 are required; a response of N/A would not be appropriate where the standard indicates that the practitioner shall make such inquiries of management.

[CSRE 2400 paragraph 47 designing and performing procedures]

QUALITY MANAGEMENT

Some practitioners have not performed ongoing evaluations of their quality control system, nor have they completed their cyclical monitoring. Engagement monitoring activities have a positive impact on engagement quality and are expected to be performed.

CSQM 1 and CSQM 2 replaced CSQC 1 as of December 15, 2022 for assurance engagements. In a number of the practice inspections performed since the effective date of the new standard, it was noted that the system of quality management was not updated to be in line with the new standard.

As of December 15, 2023, CSQM 1 and CSQM 2, will apply to related services engagements, which include compilation and trust engagements.
Canadian Standard on Quality Management (CSQM) 1: This standard will replace CSQC 1 and is focused on quality management for firms that perform audits or reviews of financial statements, other assurance or related services engagements, which will notably include compilation engagements. **Therefore, many sole practitioners and small firms will, for the first time, need to design, implement and operate a system of quality management. As a note, related services engagements do not include tax and consulting services that may be offered by a practitioner, but will include legal and real estate trust engagements.**

Canadian Standard on Quality Management (CSQM) 2: This standard is focused on the importance of the role of Engagement Quality Reviews (EQR), currently referred to as Engagement Quality Control Reviews (EQCR). CSQM 2 has been extracted, updated and expanded in a stand-alone standard which is currently included in CSQC 1. This standard emphasizes the importance of the engagement quality reviewer's role and discusses the appointment and eligibility of an engagement quality reviewer, along with enhanced performance and documentation requirements of the EQR.

As many sole practitioners and small firms have not had to implement a quality standard in the past, it is highly recommended that these practitioners understand the new standards and how the standards will need to be implemented. Practitioners should review the *Handbook*, attend professional development courses, and refer to CPA Canada's CSQM resource page for further guidance.

COMPILATION ENGAGEMENTS

The Canadian Standard on Related Services (CSRS 4200) came into effect for compiled financial information for periods ending on or after December 14, 2021. As such, the majority of compilation files inspected relate to periods covered by CSRS 4200, instead of Section 9200. As many are aware, the new compilation standard represents a significant departure from Section 9200. Practitioners should ensure that they have reviewed the CSRS 4200 standard in the *Handbook*, attend a CSRS 4200 professional development course, and refer to CPA Canada's CSRS 4200 resource page for further guidance.

The following common deficiencies arose during this cycle of practice inspection:

01

Not adopting CSRS 4200 - some firms inappropriately attached a Section 9200 Notice to Reader report to the financial information prepared for a period ending on or after December 14, 2021.

02

Not adequately adopting CSRS 4200 - some firms did not sufficiently adopt the new standard into their working papers. The documentation in the working paper files must meet the requirements as set out in CSRS 4200. This includes documentation regarding independence, client acceptance, knowledge of the business and an acknowledgment from management.

03

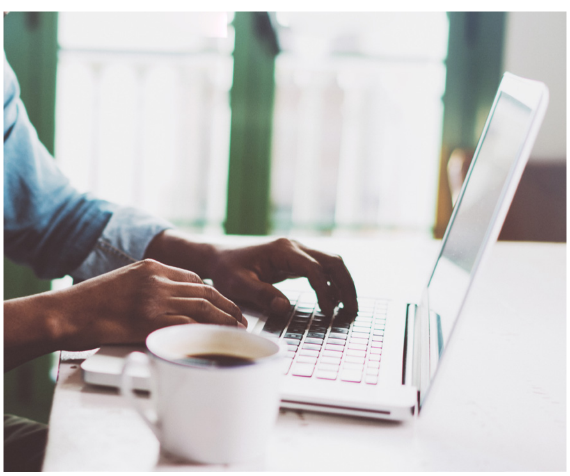
Omitting a basis of accounting note - the basis of accounting note is a core element of the new standard. The purpose of the basis of accounting note is to help the users of the financial information understand how the financial information was prepared, and must be included.

04

Inaccurate or misleading basis of accounting note - having an inaccurate or misleading basis of accounting note. For example, stating in the basis of accounting note that financial information is prepared in accordance with ASPE when there is no statement of cash flow, nor any of the required disclosures under ASPE, would be inaccurate and misleading.

QUESTIONS

Should you have questions and/or require more information on any of this information, please contact paservices@cpamb.ca.



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