

Memo

To: All Public Accounting Firms

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Re: FOCUS ON PRACTICE INSPECTION REPORTABLE DEFICIENCIES – 2017-18

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INTRODUCTION

The objective of Practice Inspection is to protect the public while assisting practitioners comply with professional standards. As such, the Practice Inspection function reviews the annual inspection results to identify areas where adherence to the CPA Canada Handbook recommendations could be improved and issues this summary to provide guidance to practitioners.

ASSESSMENT OF PRACTICE INSPECTION FINDINGS

The role of the Practice Inspection Committee (PIC) is to determine the action to be taken following an inspection. Factors the PIC considers may include, but are not limited to:

- the degree to which the requirements of the practice inspection program have been met;
- the nature and severity of any identified deficiencies (reportable deficiencies);
- the cooperation of the member/firm;
- the public interest; and
- on a re-inspection, the results of the previous inspection of the member/firm and the degree to which the member/firm addressed deficiencies identified in that inspection.

A referral to the Complaints Investigation Committee (CIC) will occur when the PIC is of the view that it cannot effect appropriate remedial action or it is required in the public interest. Other matters resulting in a referral include a breach of the CPA Manitoba Code of Professional Conduct and/or a practitioner completing and engagement that he/she does not have a valid permit to perform.

The most common departures from professional standards identified during the 2017-18 inspection cycle are included in Appendix A; these include deficiencies with respect to audit, review and compilation engagements, documentation and implementation of quality control policies and procedures, and financial statement presentation and disclosure. It is important to note that Practice Inspection does not establish standards; members/firms are expected to adhere to the professional standards set out in the CPA Canada Handbook and CPA Manitoba's Act, bylaws and related policies and our Code of Professional Conduct.

AREAS OF FOCUS

Quality Control Policies and Procedures

Firms that carry out assurance engagements are required to maintain a Quality Assurance Manual (QAM) that is in line with the requirements set out in CSQC1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*. Many firms utilize QAM templates published by CPA Canada as the basis for documenting the firm's system of quality control and applicable policies. Firms are reminded that their QAM must be customized and appropriately reflective of the nature of the firm's services. It is also the firm's responsibility to modify their QAM for any changes to CSQC1 as well as regularly review their QAM for any outdated policy requirements or changes to quality control processes within the firm. Note: there is currently an international project to make extensive revisions to the international quality control standard.

The review process forms one of two monitoring requirements set out in CSQC1: firms must complete both annual monitoring and cyclical monitoring processes. Some firms misunderstand that these monitoring processes have different requirements. Ongoing or annual monitoring activities are intended as a firm “check-up” on the state of the firm’s overall quality control system and to make updates to the QAM where issues have been identified within the past year. Cyclical monitoring assesses the firm’s quality control system at the engagement level (at an appropriate interval) and includes the inspection of at least one completed assurance engagement for each engagement partner. Cyclical monitoring is completed by a suitably qualified individual with no previous involvement with the engagement. Practice inspection completed by the provincial body does not satisfy the cyclical monitoring requirement. Sole practitioners may need to seek out appropriately qualified individuals externally to complete cyclical monitoring.

Firms are expected to address and evaluate any deficiencies identified during monitoring activities. Firms should focus on identifying the root causes of deficiencies to help to develop and implement effective action plans to address deficiencies within a reasonable period of time. Action plans can vary among firms but may include firm communications to staff, increased staff training or increased file reviews. Deficiencies identified during monitoring activities are an indicator of lack of consistency in application of the firm’s quality control system; therefore, updates to a firm’s QAM may be required.

Firms are reminded that an understanding of the measurement, recognition, presentation and disclosure requirements of the financial reporting frameworks contained within the Accounting Handbook is essential for performance of assurance engagements. We have observed that a poor understanding the accounting standards in Part II Accounting Standards for Private Enterprises and Part III Accounting Standards for Not-for-Profit Organizations is a root cause of many assurance engagement deficiencies in practice inspection.

Audits

A significant component of audit quality is adequate documentation. In our inspections, we have found that many deficiencies result from inadequate documentation. Frequently, discussions with the practitioner reveal that procedures have been carried out and the practitioner has additional knowledge of the client, but the procedures and knowledge have not been adequately documented in the file.

If it is not documented – it is not done

In order to obtain sufficient appropriate evidence to support an audit opinion, a practitioner must comply with CAS 230 Audit Documentation. If evidence is not well documented, the audit has not been performed in accordance with CAS 230.

Audit documentation that meets the requirements of CAS 230 provides:

- evidence of the basis for a conclusion about the achievement of the auditor’s overall objectives; and
- evidence that the audit was planned and performed in accordance with CASs and applicable legal and regulatory requirements.

Furthermore, the standard requires that audit documentation be sufficient to enable an experienced auditor to understand:

- the nature, timing and extent of the procedures performed;
- the results of the procedures performed and the audit evidence obtained; and
- significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

Adequate documentation is important at all stages of the audit, from planning to conclusion.

Audit Planning

An audit plan is the foundation of an efficient and effective audit. Documentation should cover:

- the determination of overall and performance materiality as well as specific account materiality, when applicable;
- understanding the entity and its environment;
- the entity’s internal control systems, including the control environment, risk assessment process, information systems and monitoring controls;

- identifying control activities relevant to the audit;
- identifying and assessing the risks of material misstatement; and
- the planned audit responses to address the risks at the financial statement and assertion levels.

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.

Identifying, assessing and documenting risks in the entity is also an integral part of the planning process. Identifying significant risks, including those that encompass fraud risk, will focus the audit team’s attention on the accounts and assertions that represent the greatest risk.

Once the audit plan has been established, it is best practice to create a memo that identifies the risk areas and the planned audit response to gain sufficient, appropriate evidence to mitigate these risks. The planning memo should be updated on an ongoing basis as new risks are identified.

Performance of the Audit

Documentation is also a key component during the performance phase of the audit. Preparing sufficient and appropriate documentation on a timely basis enhances the quality of the audit and facilitates the effective review and evaluation of the evidence obtained and conclusions reached before the auditor’s report is finalized.

While audit programs are useful to facilitate the completion of audit procedures, signing off a step in an audit program with “yes”, “no”, or “completed no exceptions” will rarely constitute sufficient documentation in accordance with CAS 230. Further detail should be provided as to the nature, timing and extent of procedures performed, the evidence obtained, the results of the procedures and the conclusion reached. This can be documented directly on the audit program or with a reference to the relevant working paper(s) where the procedures are carried out.

For example:

An audit client has one long-term receivable and the balance is material to the financial statements. The auditor tested the receivable for existence, rights and valuation and the results were:

- No significant findings or issues were noted;
- No significant judgements were made.

The audit program is signed as follows:

Procedure	Comments	Done By
Test receivable for existence, rights and valuation	Completed, no exceptions	FR Jun 3, 17

There is a conclusion that states: “The audit evidence obtained is sufficient and appropriate to reduce the risk of material misstatement to an acceptably low level.” A file reviewer has also signed off and dated the working paper.

If the adequacy of this level of documentation were compared to the requirements of CAS 230, we would conclude as follows:

CAS 230 Requirements	Documentation Adequate?
The nature and extent of the procedures	This requirement has not been met. While we know which assertions the auditor tested, we have no idea what the auditor did to test them.
The timing of the procedures	This requirement has been met by the signoff and date of signoff by the preparer and reviewer.
The results of the procedures	This requirement has been met by the comment - “no exceptions”.
The audit evidence obtained	This requirement has not been met as we have no idea about the evidence obtained.
Significant matters arising or judgements made	The conclusion provides the result of the judgement made (i.e. that the audit evidence is sufficient)

In this example, if a note was added to the program specifying the work done, such as “Agreed balance to the long-term receivable agreement; checked the client’s interest calculation; traced receipts during the year to the bank statements; recalculated receivable amount and confirmed amount with debtor”, the requirements of CAS 230 would have been met.

Documentation should show, at a minimum, the purpose of the audit procedure, the items selected, the characteristics being tested, the result of each test and the conclusion drawn upon completion. Application guidance in CAS 230 states, “Recording the identifying characteristics serves a number of purposes. For example, it enables the engagement team to be accountable for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested.”

The following are some examples of appropriate documentation for common audit procedures:

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
- For a procedure requiring testing of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all repairs and maintenance expense entries over a specified amount from the ledger).
- For a procedure requiring inquiries of specific entity personnel, the auditor would record the response received along with the dates of the inquiries and the names and job titles of the entity personnel.
- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period from April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.
- For the procedures for journal entry testing, the auditor would document the characteristics of journal entries that would be selected for testing. These would be those having the highest risk of material misstatement and factors to consider would be the timing of the entry, the person who prepared the entry, the dollar value of the entry or some other criteria identified by the auditor from their risk analysis.
- For control testing, documentation should indicate the assertions being tested, the control tested and the design of the test that would ensure that sufficient appropriate evidence as to the operating effectiveness of the relevant controls throughout the period of reliance.

High-quality working papers will always have sufficient information to allow the audit procedures to be easily re-performed by someone not familiar with the audit client.

In addition to documentation of audit procedures as discussed above, documentation of areas requiring significant professional judgement and/or reliance on discussions with management warrant special consideration.

Professional Judgement

An important factor in determining the nature and extent of audit documentation is the degree of professional judgement exercised in performing the work and evaluating the results. Documentation of judgements made, where significant, serves to reinforce their quality and explain the auditor’s conclusions. Documentation of significant matters and judgements facilitate the review process and provide valuable information for planning and performing the audit in subsequent years.

Evidence Obtained Through Discussions with Management

When relying on information obtained through discussions with management, professional skepticism should be applied and corroborating evidence obtained to support any explanations. The nature of the discussions, as well as the corroborating evidence, should be documented to provide a record of who the matters were discussed with, when they were discussed, what was discussed, how this discussion was corroborated and the conclusions reached.

Other Auditing Standards

While CAS 230 is the audit documentation standard, many of the other auditing standards have specific documentation requirements that should not be overlooked. These other sections do not override the requirements of CAS 230 but expand and reinforce these requirements. The appendix to CAS 230 provides a list of specific documentation requirements that can be found in the other audit sections.

Review Engagements

As with audit engagements, one of the key drivers behind the reportable deficiencies raised during inspections is insufficient documentation. Many responses received from firms include comments that matters were discussed with the client but had not been documented.

CSRE 2400, Engagements to Review Historical Financial Statements, became effective for periods ended on or after December 14, 2017 (early adoption was not permitted). This standard sets out areas where an enhanced level of documentation is required and, in contrast to the “old” review engagement standard, places greater emphasis on the practitioner’s professional judgement, in particular in the determination of where material misstatements are likely to arise.

Documentation requirements for a review engagement under CSRE 2400 are specifically addressed in paragraphs 104-107. In particular, documentation should be sufficient for an experienced practitioner, having no previous connection with the engagement, to understand:

- the nature, timing and extent of procedures performed (including who performed the work and the date it was completed, and who reviewed the work and the date of the review);
- the results obtained from the procedures performed and the practitioner’s conclusions arising therefrom; and
- significant matters arising during the engagement, the practitioner’s conclusions and significant professional judgements made to reach those conclusions.

Certain aspects of audit documentation discussed in the section above will assume relevance in the performance of review engagements. In particular, practitioners should ensure that:

- documentation around understanding the entity and its environment is complete and adequate;
- documentation of the entity’s accounting systems and accounting records is included in the working paper files;
- documentation is made of areas in the financial statements where material misstatements are likely to arise;
- procedures are performed and documented of all the material items and areas where material misstatement are likely to arise; and
- all responses to inquiries of management are clearly documented.

Compilation Engagements

The exposure draft for the new compilation engagement standard has recently been published. We expect the new standard to further improve the quality of work completed by practitioners on compilation engagements. As a reminder, firms must take care to appropriately document their assessment of engagement acceptance or continuance and of their independence for each compilation engagement.

Financial Statement presentation and Disclosure

One of the most common financial reporting deficiencies related to the measurement, presentation and disclosure of related party transactions. Such transactions can present certain complexities and practitioners are reminded to refer to the relevant guidance, including decision trees and illustrative examples, to ensure proper accounting.

Misclassifications and other errors in cash flow statements were also common deficiencies. Sometimes overlooked, the statement of cash flows is an integral part of financial reporting that ties the other statements together for a complete picture of how a company generates and uses cash and cash equivalents.

Appendix A sets out the other common inspection deficiencies related to financial statement presentation including inappropriate presentation of debt due on demand as long-term and inappropriate or missing revenue recognition policies for all significant revenue streams.

RESOURCES

In addition to the CPA Canada Handbooks on Accounting and Assurance (which can be found at Knotia.ca and are free for all CPA Canada members), there are many other resources available at no charge to members. One such resource is [CPA Manitoba's Advisory Services](#), where members can get help in interpreting the CPA Manitoba Code of Professional Conduct, bylaws and related policies, as well as technical standards contained in the CPA Canada Handbooks and guidance on various practice management issues.

Two other good resources are the [CPA Canada website](#) and the [Financial Reporting & Assurance Standards Canada website](#). These websites contain useful guidance on all the Canadian accounting frameworks and assurance standards, along with information on developing issues and discussions on proposed new standards.

APPENDIX A

Common Deficiencies in Compliance with Professional Standards

Canadian Standards on Quality 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 paragraph 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 paragraph 48

- The firm did not perform an ongoing consideration and evaluation of the firm's system of quality control.

CSQC 1 paragraph 48

Audit Engagements

- The written letter of representation obtained from the client's management and, where appropriate those charged with governance did not include all required elements.

CAS 580 paragraphs 10 and 12; CAS 240 paragraph 39; CAS 580 paragraph 13

- 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

- 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 paragraphs 7-11 and 14-15

- The auditor did not obtain an understanding of the control environment, control activities relevant to the audit and an understanding of the information systems, including the related business processes, relevant to financial reporting.

CAS 315 paragraphs 14, 18 and 20

Audit Engagements

- 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.

CAS 315 paragraph 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.

CAS 240 paragraphs 17, 18 and 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.

CAS 240 paragraphs 21 and 22

- The auditor did not identify and assess the risks of material misstatement at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.

CAS 315 paragraph 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 paragraph 26 and 27

- The auditor did not evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. When assessing risk, the auditor shall consider whether unusual or unexpected relationships exist.

CAS 240 paragraphs 23 and 35

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

CAS 240 paragraphs 16, 22; CAS 315 paragraph 6

Review Engagements

- The public accountant did not adequately document whether the information being reported on is plausible in the circumstances within the framework of appropriate criteria. Such a review should consist of inquiry, analytical procedures and discussion; and additional or more extensive procedures when the public accountant's knowledge of the business carried on by the enterprise and the results of the inquiry, and analytical procedures and discussion cause him or her to doubt the plausibility of such information.

Section 8100 paragraph 8, .15 and .19-.24

- There was no documentation that the public accountant had formed a conclusion on compliance with independence requirements or whether appropriate procedures regarding the acceptance and continuance of the client relationship and the specific assurance engagement had been performed and the conclusions reached.

Section 5030 paragraphs 10, 15 and 18; CPA Code of Professional Conduct Rule 204.2, 204.3, 204.6

Review Engagements

- There was no documentation to support the date of the public accountant's report. Because the reader is entitled to assume that the public accountant has performed sufficient procedures to that date to support the conclusion expressed in his or her report, the public accountant's report cannot be dated until the financial statements have been completed and management has acknowledged responsibility for them.

Section 8100 paragraph 30; AuG-47

- Management's written representations were not effective as of the date of the review engagement report or missing entirely.

Section 8200 paragraph 35

- Representation letters often did not include all required matters. The public accountant should obtain management's written representations regarding matters that are important to support the content of his/her report for all financial statements reported on. The letter should also specify the financial reporting framework.

Section 8200 paragraphs 31 and 33

Compilation Engagements

- There was no documentation that the public accountant had considered whether there were any matters that would impair his/her independence. If any matters have been identified, the nature and extent of the impairment will need to be disclosed in the notice to reader communication.

CPA Code of Professional Conduct, Rule 204.10 (formerly Rules of Professional Conduct, Rule 204.9)

- The public accountant did not document in the file that an understanding and agreement with the client had been reached as to the services to be provided.

Section 9200 paragraph 16

Financial Statement Presentation

- An enterprise did not disclose all the required information about its transactions with related parties including, but not limited to, a description of the relationship between the transacting parties, the measurement basis used, the terms and conditions for the amounts due to or from related parties, a description of the transaction(s), including those for which no amount has been recognized and the recognized amount of the transactions classified by financial statement category.

Part II Section 3840 paragraph 51

- An entity did not disclose the carrying amount of any financial liabilities that are secured, together with the carrying amount of assets it has pledged as collateral for liabilities and the terms and conditions relating to its pledge.

Part II Section 3856 paragraph 44

- When an enterprise applied the taxes payable method of accounting for income taxes, the financial statements did not disclose 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, and the amount of unused income tax losses and unused income tax credits carried forward.

Part II Section 3465 paragraph 88

- A debt obligation that was due on demand was inappropriately classified as long-term debt.

Part II Section 1510 paragraphs 10, 12, and 13

Financial Statement Presentation

- An enterprise did not state prominently in the notes to its financial statements that its financial statements were prepared in accordance with Canadian accounting standards for private enterprises.

Part II Section 1400 paragraph 16

- For preferred shares issued in a tax planning arrangement, an entity did not disclose the amount for these preferred shares described as redeemable at the option of the holder, as a separate line item in the equity section of the balance sheet, together with the total redemption amount for all classes of such shares outstanding on the face of the balance sheet and the aggregate redemption amount for each class of such shares.

Part II Section 3856 paragraphs 23 and 47

- The major categories of revenue recognized during the period were not disclosed separately by the entity.

Part II Section 1520 paragraph 4; Section 3400 paragraph 33

- An enterprise did not disclose the revenue recognition policy for each material type of transaction.

Part II Section 3400 paragraph 31

- Amounts payable at the end of the period with respect to government remittances (other than income taxes) were not disclosed.

Part II Section 1520 paragraph 15

- For bonds, debentures and similar securities, mortgages and other long-term debt, an entity did not disclose; 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.

Part II Section 3856 paragraph 43

- For revenues of a not-for-profit organization, other than revenues from contributions, the revenue recognition policy was not disclosed.

Part II Section 1505 paragraphs 3 and 6; Section 3400 paragraph 31; Part III Section 4410 paragraph 01

- The financial statements of a not-for-profit organization did not include a description of the organization's purpose, intended community of service, status under income tax legislation or legal form.

Part III Section 4400 paragraph 4