



THE PRACTITIONER'S VIEW

Vol. 5, Issue 2 December 2003

COMMON PSR FINDINGS

Practice reviews carried out this fall identified certain common areas of non-compliance with accounting and assurance standards that were quite predictable. Differential reporting, independence and fraud and error matters routinely arose as findings, indicating that practitioners are struggling to keep up with new requirements, all of which became effective for reports issued in 2003. Many practitioners were not aware that December 15th, 2002 was the implementation date for fraud and error considerations as well as communication of independence. This is a common problem throughout Canada, as the following article, from the October 2003 issue of ICABC News 'N Views, indicates.

WHAT HAVE YOU MISSED?

(Adapted from an article in the October 2003 issue of News 'N Views, a publication of the Institute of Chartered Accountants of BC)

Section 1300 – Differential Reporting

Practitioners are failing to recognize situations where differential reporting can be applied. Common scenarios include:

Financial Instruments

Clients who have undergone Section 85 reorganizations have traditionally issued shares that are retractable at the option of the holder. CICA Handbook Section 3860 requires the client to disclose the retractable shares as a current liability valued at the full retraction price unless they elect to use the disclosure option available under differential reporting. Members are reminded that disclosure of financial instruments is required for all assurance engagements as the former deferral of application of the full Handbook Section 3860 expired December 31, 2002. The required disclosures can be reduced by electing to follow the provisions under differential reporting.

Subsidiaries

In order to comply with GAAP, companies with investments in subsidiaries must prepare consolidated financial statements unless they elect otherwise under the provisions of differential reporting. However, many practitioners have continued to use the "soft qualification" previously allowed when companies have continued to carry subsidiaries at cost. The "soft qualification" may no longer be used.

The same comments apply to investments, which should be accounted for using the equity method under CICA Section 3050 – Long Term Investments.

Income taxes

We are still seeing "deferred taxes", which is no longer an option since the introduction of Section 1300. Clients must choose between the taxes payable method under differential reporting and the liability method, recording future tax assets and liabilities.

Documentation

Practitioners whose clients have elected certain provisions of differential reporting need to bear in mind two issues pertaining to file documentation. Firstly, you will need to revise your engagement and representation letters to incorporate differential reporting. Secondly, the client will need to confirm in writing the shareholder's unanimous agreement (including those not otherwise permitted to vote) to the specific differential reporting options adopted in the financial statements. A general reference to the adoption of differential options is not acceptable. (See the Professional Engagement Manual for updated forms and letters).

Section 3061 – Property, Plant And Equipment

The changes required by this section have largely gone unnoticed by practitioners as they were introduced in conjunction with the changes to Section 3062 – *Goodwill and Other Intangibles*. The term "Capital Assets" refers to both tangible and intangible assets. As a result, using the term "Capital Assets" to describe only tangible capital assets is no longer appropriate. Some variation of "Property, Plant and Equipment" is likely an appropriate caption.

Practitioner's View is a regular publication of the Institute of Chartered Accountants of Nova Scotia to inform and to serve members who are involved in public accounting in Nova Scotia.

EIC 122 – Balance Sheet Classifications Of Callable Debt Obligations

Any debt, irrespective of its agreed repayment terms, must be disclosed in its entirety as a current liability if the holder of the debt has the ability to recall the debt at its sole discretion. A significant amount of commercial bank debt falls into this category. Practitioners have frequently just carried over prior years' disclosure of the debt without taking steps to see if EIC 122 applies. Where practitioners have identified the issue, it has been handled well through either proper disclosure or appropriate qualification of the assurance report.

Section 5135 – The Auditor's Responsibility To Consider Fraud And Error In An Audit Of Financial Statements

Again, the changes required by this section have gone largely unnoticed. Practitioners must address the risk of material financial misstatements arising from fraud and error and document the procedures completed and conclusions reached. Also, significant changes to management's letter of representation, including management's acknowledgment that the unrecorded errors discovered by the auditor are not material, are required. Most practitioners reviewed this year have not complied with this requirement. (See the Professional Engagement Manual for updated forms and letters).

Communicating With Audit Committees – Or The Equivalent

Section 5751 of the CICA Handbook for *Communications With Those Having Oversight Responsibility for the Financial Reporting Process*, became effective for fiscal years ended on or after ended on or after December 15, 2002. The requirements as set out in this section apply to all entities and to both audits and reviews (to a lesser extent, see Handbook Section 8200.30).

In particular, auditors and accountants must communicate matters that affect independence and confirm in writing that they are independent within the meaning of the Rules of Conduct on an annual basis PRIOR to issuing the auditor's or review engagement report. For an example of the communication for audit engagements, see the CICA Handbook or Professional Engagement Manual, and for review engagements, see Appendix A to this newsletter (sample letter provided by the BC Institute, modified for ICANS).

Section 8200 - Accountants Review Of Financial Statements

Section 8200 contains a requirement to document the client's control systems related to the preparation of the financial statements and the manner in which transactions are recorded, classified and summarized (paragraph 8200.02). One way members can easily comply with this requirement is to complete the Knowledge of Business memo available in the Professional Engagement Manual.

Other

Other common deficiencies noted this year include:

Financial Statement Presentation

- Related parties – nature of the relationship, basis of measurement of transactions
- Financial instruments – credit risk and interest rate risk, including interest rate and authorized amount for line of credit as well as interest rates for temporary investments
- Not-for-profit organizations - inadequate disclosure of Net investment in Capital Assets, restricted funds, tax status, purpose of various funds, method of accounting for contributions
- Interest and income taxes paid

File documentation

- Representation and engagement letters not updated for changes in standards, specifically for fraud/error and independence
- Knowledge of the entity's business for both audits and reviews
- Poor documentation of internal controls and systems
- Poor documentation of procedures performed on the statement of income, whether tests of transactions or analytical procedures
- Poor documentation of cut-off procedures, inventory client count procedures and valuation, subsequent events and contingency reviews, analytical review of balance sheet items, overall analytical review for audits

STANDARDS OVERLOAD - WHAT CAN YOU DO?

With accounting principles and assurance standards now changing faster than they ever have, it is imperative that members take all of the steps necessary to keep current their knowledge of the CICA Handbook. Steps such as attending annual PD updates, in-depth courses on specific areas, reading Practitioner's View, subscribing to the Professional Engagement Manual and forms, using the most recent Caseware/Caseview programs as well as contacting the Institute for information and discussion, will go a long way in keeping up to date.

The Institute has invited Paul Cherry, Chair of the Accounting Standards Board (AcSB), to participate in a session on standards in late January. Details will be provided when available.

PRACTICE INSPECTION – OVERVIEW

Practice inspection has been in place in Nova Scotia for almost twenty years. Is it necessary and what has it accomplished?

Practice inspection is necessary for a self-regulating profession and is therefore mandatory, as it is elsewhere in Canada. As to whether it meets its objectives, consider the program's mission statement:

"The main purpose of the professional standards review program is to support the Institute in achieving its mission of helping members to serve the public interest and the needs of their clients and employers. The professional standards review program contributes to this mission by ensuring that all members practicing public accounting maintain the prescribed level of professional standards – standards of competence, objectivity and ethical conduct as they relate to accounting and assurance services"

As such, the program's emphasis is educational – encouraging members to continually enhance their capabilities.

Over the last twenty years, standards have changed at an ever-increasing pace and practitioners have, on the whole, met the challenge of implementing these changes. It can be seen that the program's objective has been met and that it continues to be relevant. In fact, when new standards have required significant time and effort to understand and implement, the committee recognized this by underscoring the educational emphasis of the program and usually recommended no further action at the time. However, the objective of serving the public interest would not be met if compliance with standards continued to be an issue after a certain grace period. While reinspection rates vary from year to year, they are consistent with or lower than other provinces and NO referrals have been made to professional conduct.

WHAT'S NEW

(Adapted from an article in the October 2003 issue of News 'N Views, a publication of the Institute of Chartered Accountants of BC)

CICA Handbook Section 5600

New CICA Handbook Section 5600 - issued in September 2003 - covers "*Auditor's Report On Financial Statements Using A Basis Of Accounting Other Than Generally Accepted Accounting Principles*". This section came into effect for auditor's reports dated on or after October 1, 2003. Note that the reference is to the report date as opposed to a fiscal period.

The take-home message of Section 5600 is that it **does not apply to general purpose financial statements**. For further guidance, check out the bulletin titled "Section 5600: Does it apply to me?" recently issued by the Auditing and Assurance Standards Board. It can be accessed at www.icca.ca/index.cfm/ci_id/18728/la_id/1.htm.

If you were issuing audit reports prior to October 1, 2003 in any of the following more common circumstances (as well as others outlined in the bulletin), revisions will be required to reports issued after that date:

- Non-consolidated financial statements
- Pension fund financial statements
- Financial statements of a co-operative housing association filed with or prepared in accordance with CMHC requirements
- General purpose financial statements prepared using a basis of accounting other than GAAP

Auditor reports can no longer include a "soft qualification" or wording such as "in accordance with appropriate disclosed basis of accounting disclosed in Note X"; or "in accordance with generally accepted accounting principles for (industry); or "in accordance with accounting principles prescribed by (legislative authority)".

Given the significant changes in audit reporting standards for engagements meeting the circumstances described in this bulletin, practitioners are advised to alert their clients of the implications on the form of the auditor's report.

Practitioners should also be aware that they are permitted to accept an engagement under 5600.07 only when it is confirmed, in writing, by the entity that the financial statements reported on are not general-purpose financial statements.

Financial Statements of Governments

As noted in the December 2003 issue of *Risk Alert*, a CICA newsletter, because financial statements of governments are ordinarily general purpose financial statements, the auditor would not report under Section 5600. Instead, the auditor would refer to *Audit of Government Financial Statements*, Section PS 5200.

On January 28 and 29, Service Nova Scotia and Municipal Relations will host a two-day workshop designed to assist municipalities in understanding the recent changes to the Canadian Institute of Chartered Accountants Assurance Standards and the implications for municipalities' financial statements and tax rate calculations.

The workshop will be held in Halifax, January 28 and 29. In order to finalize meeting space and meal arrangements, the Department needs to confirm the number of attendees, so please advise Wendy Dauphinee (wdauphin@gov.ns.ca or 424-6338) no later than January 21 if you plan to attend.

Auditor Association With Annual Reports

Section 7500, *Auditor Association with Annual Reports, Interim Reports and Other Public Documents* has been revised and becomes effective for all documents issued on or after November 1, 2003. Members should be aware that this section is not restricted to public companies but rather affects both profit and not-for-profit organizations. If any of your clients publish annual reports that include financial statements on which you have performed an audit or review, you will likely need to perform additional procedures to comply with the new requirements.

This means before you consent to the use of your report or your name in the document, you are required to read the other information in the document to ensure there is no inconsistency with the financial statements.

Members should be aware that when releasing revised Section 7500 this past summer, the ASB also issued new Handbook Sections 7100, *The Auditor's Involvement with Offering Documents of Public and Private Entities* and 7115, *Auditor Involvement with Offering Documents of Public and Private Entities – Current Legislative and Regulatory Requirements*. Members who provide audit services to companies that raise capital through offerings will want to take a careful review of all three sections.

CAMagazine published an article in the September 2003 issue to assist members in understanding these new Handbook sections.

Exposure Draft On Quality Control

In November 2003, the Auditing and Assurance Standards Board (AASB) issued an Exposure Draft (ED) *Quality Control for Firms and Practitioners Performing Assurance Engagements*. The comment period - originally scheduled to end on January 6, 2004 - has been extended to February 6, 2004. For further discussion, see the December 2003 issue of *Risk Alert*, a CICA newsletter, as well as accessing the exposure draft at http://www.cica.ca/multimedia/Download_Library/Standards/ASB/English/e_QControlFirm.pdf.

This important ED could have significant impact on audit standards for engagements of all sizes. Thus we encourage all firms - particularly small firms and sole practitioners - to read and consider the impact of this ED on your firm and make any concerns known to the AASB by responding to the ED.

SPECIAL EDITION - FYI

FYI is a newsletter from the Accounting Standards Board (AcSB) that periodically informs members of changes in accounting standards. The Special Edition 2003 summarizes pronouncements of the AcSB and the Emerging Issues Committee that should be considered in financial statement preparation for 2003 and 2004 fiscal years. The special edition can be accessed at http://www.cica.ca/multimedia/Download_Library/Standards/Accounting/English/e_FYIspecial03.pdf.

PEM UPDATE

The most recent update to the PEM, #32 dated September 2003, focuses on risk assessment and fraud and also includes material on privacy.

Highlights include:

- Updated engagement letters for compilations, audits and reviews that limit distribution of the report and include indemnity provisions;
- Updated representation letters; and
- Updated shareholders consent letters, recognizing that goodwill will be tested for impairment.

There are also updated sample forms for:

- Planning the audit engagement;
- Knowledge of business checklists;
- Audit programs – Property, Plant and Equipment, incorporating the new accounting standards for impairment of long-lived assets.

Two new forms will be of interest to practitioners, a *Team Planning Meeting Worksheet* and a *Risk Assessment Worksheet*. The Risk Assessment Worksheet can be used as an alternative to the Inherent Risk Questionnaire, Identification of Possible Fraud Risk Factors and the Control Environment Questionnaire, as it combines all three considerations by twelve subject areas.

INDEPENDENCE STANDARD – PRACTICE AID

At the time of the vote on the independence standard, the Institute undertook to assist practitioners with implementation of Rule 204 by providing templates. We are presently considering a form developed by other PICAs and have distributed this to a group of practitioners for their comments. After consideration of any special requirements for its applicability in Nova Scotia, we intend to distribute this for your possible use.

Should you wish to participate in similar future initiatives, please contact Wenda Bennett at wbennett@icans.ns.ca.

FISHING LICENSES

The Institute continues its efforts to ensure that Atlantic fishers have reasonable access to the tax advantages provided to small businesses regardless of DFO policy on the transfer of licenses. You will recall that CCRA announced its intention in June to not only no longer allow fishers to transfer fishing rights pursuant to legal agreements but also to retroactively re-assess those fishers and corporations which entered into such agreements in the past. If you have fisher clients and would like more information on the status of this matter, please contact the Executive Director at rcaswill@icans.ns.ca <<mailto:rcaswill@icans.ns.ca>>.

PRACTICE MANAGEMENT and DEVELOPMENT

Guidance For Small And Medium Sized Practices

The International Federation of Accountants (IFAC) has issued two new guides to assist small and medium sized practices (SMP) and their clients manage and operate their computer systems:

- Controlling Computers in Business: Back-Up, Archive and Restore; and
- Controlling Computers in Business: Physical Security.

Both are available for free downloading on IFAC's website at www.ifac.org/store under the SMP section. Each contains discussion on specific computer control issues and a best practice checklist. Check them out!

Privacy Legislation

The federal government passed the Personal Information Protection & Electronic Documents Act (PIPEDA), which comes fully into force on January 1, 2004. All businesses that collect use or disclose personal information about their employees, customers, or others in the course of commercial activities will be subject to PIPEDA.

Much of the privacy legislation should have little direct impact on the operation of members' practices, as the profession already has strong confidentiality requirements. There is one concern, however, that privacy legislation may impact on your ability to perform some engagements and access some information from your client files. You should note however that the September 2003 updates for the Professional Engagement Manual contains additional wording in the sample engagement letters about confidentiality. You should ensure that your letters are appropriately changed.

This new legislation will obviously affect your firms' clients; so if you haven't already done so, learn more about the new privacy laws as a client service opportunity.

Improving Work Efficiency

The June 2003 issue of *Focus on PEM* includes an article on identifying and addressing inefficient work practices. It's definitely worth a read at the start of the busy season, especially if you're going "paperless" and haven't noticed the expected increase in productivity.

Electronic Audit Evidence

What is electronic audit evidence? What are its attributes and how does it differ from traditional audit evidence? What is its impact on the audit approach? What are the risks involved and the controls that can be applied to reduce them? The recently released CICA Research Report, *Electronic Audit Evidence*, addresses these matters and provides useful guidance for auditors and managers.

Have A Fallback Plan

"Being prepared" in the event of death or disability was a topic of discussion at the Practitioner's Workshop in Truro. *The Journal of Accountancy* also addressed this in its September 2003 issue with recommendations for developing a practice continuation plan. It provides guidance in compiling a complete set of practice operating documents as well as a comprehensive client list profile.

Interesting comment - the article notes that CPAs are seven times more likely to suffer a long-term disability than death, and the value of a practice can leak away in as little as one to three months.

To Your Health

Also worth checking out in the same issue of *The Journal of Accountancy*, is an article on maintaining stamina and concentration during the busy season. It includes simple steps to take – both at home and at work – to develop healthful habits that mitigate stress, sustain energy and make staying fit throughout the busy season an attainable goal, even if you can't get to the gym!

MERRY CHRISTMAS
EVERYONE
&
BEST WISHES FOR A
WONDERFUL 2004

REVIEW INDEPENDENCE LETTER
On CA letterhead

[Date]

The Board of Directors [or President or Management]

Dear Members of the Board of Directors:

I (We) have been engaged to review the financial statements of [Company] for the year ending December 31, 20XX.

Canadian generally accepted review standards require that I (we) communicate at least annually with you regarding all relationships between the Company and me (us) that, in my (our) professional judgment, may reasonably be thought to bear on my (our) independence.

In determining which relationships to report, the standards require me (us) to consider relevant rules and related interpretations prescribed by the Nova Scotia Institute of Chartered Accountants and applicable legislation, covering matters such as:

- a) holding a financial interest, either directly or indirectly, in a client;
- b) holding a position, either directly or indirectly, that gives the right or responsibility to exert significant influence over the financial or accounting policies of a client;
- c) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client;
- d) economic dependence on a client; and
- e) provision of services in addition to the review engagement.

I (we) have prepared the following comments to facilitate my (our) discussion with you regarding independence matters [arising since [Date], the date of my (our) last letter].

I (we) am (are) aware of the following relationships between the Company and me (us) that, in my (our) professional judgment, may reasonably be thought to bear on my (our) independence. The following relationships represent matters that have occurred from [Date] to [Date].

[Describe any significant relationships or matters bearing on the professional's independence, and also discuss the appropriate safeguards in place.]

[OR]

I (we) am (are) not aware of any relationships between the Company and me (us) that, in my (our) professional judgment, may reasonably be thought to bear on my (our) independence, that have occurred from [Date] to [Date].

Review standards require that I (we) confirm my (our) independence to management. However, since the Rules of Professional Conduct of the Institute of Chartered Accountants of Nova Scotia deal with the concept of independence in terms of objectivity, my (our)

confirmation is to be made in that context. Accordingly, I (we) hereby confirm that I (we) am (are) objective with respect to the Company within the meaning of the Rules of Professional Conduct of the institute of Chartered Accountants of Nova Scotia as of [Date].

This report is intended solely for the use of the board of directors, management and others within the Company and should not be used for any other purpose.

I (we) look forward to discussing with you the matters addressed in this letter at my (our) upcoming meeting on [Date].

Yours truly,

CHARTERED ACCOUNTANT