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# THE PRACTITIONER'S VIEW

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## AUDIT IMPLICATIONS OF CHEQUE IMAGING

The Canadian Payments Association is leading an industry-wide initiative to adopt a new clearing process based on cheque images that will replace the traditional “paper-based” cancelled cheques. Cheque imaging involves creating a digital representation of the front and back of the cancelled cheque. The implementation of the cheque imaging initiative is targeted to begin in early 2008, with full national implementation expected to be complete in 2009. This process includes standardizing cheque specifications to facilitate accurate digital images/recording by the end of 2006. Some financial institutions have already started the cheque imaging process.

### So what impact will this have on audits?

Auditors have traditionally used paper-based cancelled cheques as a source of audit evidence. Testing often includes:

- examining cancelled cheques for payee, signing officer and endorsements
- checking for a “deposit to the account of” stamp on the back of the cancelled cheque
- inspecting paid dates to ensure cheques listed as outstanding were, in fact, issued before year end, etc.

The move to cheque imaging will not likely have a significant impact on most audits as the procedures listed above can still be performed on the “digital cheques”. With cheque imaging, auditors will need to rely on “electronic audit evidence” in the form of digital records of cheques. The use of “electronic audit evidence” is now quite common in audits, and guidance can be found in *CICA Handbook* Section 5300 *Audit Evidence*. Although not likely needed for most audits, the auditor should consider whether a service auditor’s report regarding the integrity of the financial institution’s cheque imaging process is required.

For further information on cheque imaging and cheque specifications, visit the Canadian Payments Association Web site at [www.cdnpay.ca](http://www.cdnpay.ca).

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*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.*

## EXTERNAL CONFIRMATIONS – CICA WANTS YOUR VIEWS

Practitioners have often expressed frustration with the process of obtaining bank confirmations as well as the reliability of these and other confirmations, for example, receivable confirmations for certain types of audits, such as credit unions. CICA is now participating in a project that is looking at these issues.

The External Confirmations Task Force (ECTF) is conducting a project to revise ISA 505, *External Confirmations*, and ISA 501, Part C, *Procedures Regarding Litigation and Claims*. The project's primary focus is to review the circumstances when external confirmations are required and when they are not. The project initially will address the need, if any, to, and the practicality of, requiring confirmation of bank balances and related matters from banks and legal matters from law firms. It will also consider whether current standards should be amplified and the adequacy of confirmations as a reliable source of audit evidence.

Although the survey is focused internationally, they would also appreciate any input from Canadian practitioners. A survey in **APPENDIX A** asks nine questions of practitioners regarding practical issues of the confirmation process, confirmations as a source of evidentiary value and mandating confirmations.

## INDEPENDENCE ISSUE: ASSISTING WITH THE SALE OF A BUSINESS

A recent call to practice advisory about helping an assurance client sell their business focuses on an activity that CAs may find themselves dealing with more often.

In fact, the Canadian Federation of Independent Business (CFIB), as reported in the January 2006 issue of *CA Practice Advantage*, notes that thousands of SMEs are poised to transfer ownership within the next 5 years. CICA is also addressing this trend through its publication – *Succession Planning Toolkit*.

Given that CAs often assist business owners with this type of transaction, when does an independence issue arise and can it be adequately managed with safeguards?

If the sale has not been finalized prior to the company's fiscal year end, the CA will be in a position of reporting on financial statements at least once more. Depending on their level of involvement with the sale, this may create an independence issue.

The most relevant guidance is found in CI 204/3, paragraph 186 regarding corporate finance and similar activities:

186. *Rule 204.4(33) provides that, during the engagement period, a member or firm, or a member of the firm, may not provide any of the following services to an assurance client:*
- (a) *promoting, dealing in or underwriting the client's securities;*
  - (b) *making investment decisions on behalf of the client or otherwise having discretionary authority over the client's investments;*
  - (c) *executing a transaction to buy or sell the client's investments; or*
  - (d) *having custody of assets of the client, including taking temporary possession of securities purchased by the client.*

*The Rule further provides that in the case of an assurance client that is an audit or review client, **during either the period covered by the financial statements subject to audit or the engagement period**, a network firm or a member of a network firm shall not provide such services to the client. It also provides that in the case of an audit client that is a listed entity, the firm, a network firm, or a member of the firm or network firm shall not provide such services to a related entity.*

(See CI 204/3, paragraphs 53 – 55 for a discussion of the engagement period).

Although the examples provided do not specifically include sale of assets, the same causes for concern - advocacy or self-review threats - exist. If the CA is preparing the sale agreement or identifying potential buyers, there are likely no appropriate safeguards that will reduce the threat to an acceptable level. However, if involvement was limited to activities similar to those outlined in CI 204/3, paragraph 187 (noted below) it may be possible to provide assistance as well as assurance services.

187. *Other corporate finance services may create an advocacy or self-review threat that may be reduced to an acceptable level by the application of safeguards. Examples of such services include:*

*assisting a client in developing corporate strategies; assisting a client in obtaining bank financing by explaining the financial statements to the bank; assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria; and providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions. The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:*

- *policies and procedures to prohibit members of the firm from making management decisions on behalf of the client (see CI 204/3, paragraph 130 - activities that constitute "management decisions"); and*
- *using members of the firm not part of the engagement team to provide the services.*

If you find yourself in this situation and wish to discuss it further, please call Wenda Bennett, CA at [wbennett@icans.ns.ca](mailto:wbennett@icans.ns.ca).

## **AUDIT OF A SMALL ENTITY – IMPORTANT AUDIT TECHNIQUE STUDY RELEASED**

### **A Must for Every Auditor's Library!**

A new edition of CICA's *Audit of a Small Entity*, released in May 2006, is part of the implementation guidance for several major new and revised assurance standards. First published in 1988 and revised in 1994, the latest version deals with fraud, audit risk, understanding the entity, internal control, quality control and new independence rules and how these changes affect the audits of small entities.

Generally accepted auditing standards (GAAS) apply to all entities, regardless of size. Nevertheless, auditors frequently have difficulty applying GAAS in the audit of small entities. This Study discusses the issues related to small business audits and small not-for-profit organizations and provides practical guidance on how to conduct an effective and efficient audit. It is intended to be used in conjunction with the *Professional Engagement Manual* for detailed guidance and forms.

Some of the topics covered by the Study include:

- Characteristics of a small entity (limited segregation of duties, management override, etc)
- Auditability of a small entity (can small entities be audited?)
- Independence and the provision of advisory services
- Understanding the entity and planning the audit (internal control, types of audit strategy, developing an audit plan, impact of quality control standards on audit planning for small entities)
- Audit risk (factors, components, assessment procedures, reducing risk through substantive procedures)
- Materiality and the small entity audit
- Internal control and the small entity environment
- Information technology in a small entity (general controls in small entity systems, using IT in the audit)
- Obtaining audit evidence (substantive testing procedures, including analytical review, whether to sample)
- Documentation

This publication is an excellent resource for practitioners and can be ordered through CICA publications at [www.cica.ca](http://www.cica.ca). Gerald Trites, FCA and ICANS member, is the principal author of the Study; Jerry is currently working on a new CICA Research Study – *Role of XBRL in Accounting*.

## **PROFESSIONAL ENGAGEMENT MANUAL - REVISED**

The *Professional Engagement Manual (PEM)* is also being revised for new standards. Update #36, issued in May, is a comprehensive update to the Audit Engagement chapters: the entire Audit Engagement section of the *PEM* has been rewritten to reflect the new audit approach, including all of the supporting forms, programs and checklists.

### **PEM DISCOUNT**

The *PEM* is a comprehensive practice management manual for audit, review and compilation engagements, including forms, checklists and other practice aids that assist you with improving staff productivity, reduce partner review and maintain consistent quality control standards in your practice.

Member who register for the two day "A-Z of Risk Based Audits" course schedule to run this fall, who do not have access to the PEM, which must be brought to the course, may take advantage to a special 50% discount on the initial one-year subscription, reducing the cost to \$175 for the paper or CD-ROM format, and \$200 for the Knotia Internet version.

This manual can be ordered through CICA publications at [www.cica.ca](http://www.cica.ca).

## **DEFERRAL OF FINANCIAL INSTRUMENTS DOES NOT APPLY TO NOT-FOR-PROFIT ORGANIZATIONS**

### **Deferral of Mandatory Effective Date Only for Non-Publicly Accountable Enterprises**

In March 2006, the Accounting Standards Board (AcSB) decided that non-publicly accountable enterprises may defer application of Financial Instruments — Recognition and Measurement, Section 3855, Hedges, Section 3865, Comprehensive Income, Section 1530 and related consequential amendments by one year. These new requirements will have mandatory effect for non-publicly accountable enterprises in interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The AcSB agreed to the deferral pending consideration of research into the financial reporting needs of non-publicly accountable enterprises in accordance with the AcSB's new strategic plan. This deferral applies to non-publicly accountable enterprises as defined in Differential Reporting, paragraph 1300.02. The deferral does not apply to not-for-profit organizations.

For non-publicly accountable enterprises, the deferral will in many cases mean application to calendar years beginning after January 1, 2008. However, practitioners should start working with their NPO clients **now** on implementing the necessary procedures to track the fair value of financial instruments.

The Accounting Standards Board has developed a number of tools to assist practitioners, including an eight-page brochure, *Financial Instruments - Navigating New Waters*, a thirty-two minute web presentation and implementation guidance. These may be accessed through the CICA website at [www.acbscanada.org](http://www.acbscanada.org).

**Further assistance can also be obtained through two PD courses on Financial Instruments being offered this fall by ICANS:**

#### **Accounting for Financial Instruments I**

The objective of this one-day seminar (and the related self-study materials) is to provide an introduction to the new financial instruments accounting standards released by the Canadian Accounting Standards Board. This seminar will help you implement the standards by focusing on identification of financial instruments within the scope of the standards, and the consequences of the various classification alternatives for balance sheet and income statement recognition.

#### **Accounting for Financial Instruments II**

The objective of this one-day seminar is to provide an in-depth look at how the new financial instruments accounting standards released by the Canadian Accounting Standards Board will affect the way your company accounts for some of its holdings. The seminar covers the treatment of derivative products, the models that are to be used for hedge accounting, and how to account for foreign currency transactions and gains and losses.

## **YOUR QUALITY CONTROL MANUAL**

(The following was adapted from an article that appeared in the May 2006 issue of *News & Views*, a publication of the Institute of Chartered Accountants of British Columbia. The comments apply equally to practitioners in Nova Scotia.)

Those of you who are doing assurance engagements should now have a firm quality control manual developed and in place. Practice Review's focus is shifting now to implementation. We will be looking specifically for answers to the following questions:

- If you developed your quality control manual based on the Quality Assurance Manual, has it been suitably tailored?
- Does your manual include criteria for file quality reviews?
- Is a signed annual compliance declaration on file for each of your partners, employees and contractors?
- Does your manual define scope and timing of monitor's reports?
- What were the findings of your most recent monitor's report, and what remedial actions were taken?
- Last, but not least – has your firm adopted policies and procedures designed to promote a culture based on quality (GSF-QC.009)?

## **Quality Assurance Revisited**

*Quality Assurance Revisited* is the subject of a full day PD course planned for this fall. Practicing public accountants must have a quality assurance system. It is one thing to have a quality assurance manual, and another to follow and monitor it! This course will review the results of implementation and follow up on the quality assurance manual and processes. It will discuss the implementation issues that were identified by practitioners. The course will also identify any new policies that may be required.

## **INCOME TAX SURVIVORS**

(The following article appeared in the May 2006 issue of *News & Views*, a publication of the Institute of Chartered Accountants of British Columbia and is reprinted with permission of ICABC.)

Whew, another tax season gone! The calm after the storm may provide some time to reflect on improving and building your practice going forward. Please consider setting time aside to:

- Address your firm's risk appetite and the risk-fit with your current and future clients;
- Implement quality monitoring; and
- Identify and register for Continuing Practice Development courses;

If you are one of the more senior members of our profession, and tax time is taking more and more out of you, consider your succession plan. Experts say that it could take up to five years to manage quality and client expectations through a graceful slowdown.

## **GST/HST RATE REDUCTION GUIDANCE**

(The following was adapted from an article in the June 2006 issue of *Public Practice Bulletin*, a publication of the Institute of Chartered Accountants of Alberta.)

A 1% rate reduction from 7% to 6% (GST) and from 15% to 14% (HST) will occur effective July 1, 2006.

Guidance regarding this change can be accessed from the following:

- a) 2005 Federal Budget commentary (a brief 2 page commentary)
- b) Canada Revenue Agency Questions/Answers release, dated June 2, 2006 (extensive 28 page document covering general business, consumers, real property and First Nations tax areas)
- c) New and revised questions/answers regarding the June 2, 2006 release (see item (b) for access information)
- d) GST/HST info sheet (a 4-page highlight summary)
- e) GST/HST Rate Reduction and Purchasers of New Housing
- f) GST/HST Rate Reduction - Application to Price Adjustments, Adjustments for GST/HST Overcharged, and Returned Goods
- g) GST/HST Rate Reduction - Streamlined Methods of Accounting for Small Businesses

The weblink addresses for items (b) and (d) are:

<http://www.cra-arc.gc.ca/agency/budget/2006/gstratega-e.html>  
<http://www.cra-arc.gc.ca/E/pub/qi/qi-013/qi-013-e.pdf>

The weblink addresses for items (e), (f) and (g) are:

<http://www.cra-arc.gc.ca/E/pub/qi/qi-015/README.html>  
<http://www.cra-arc.gc.ca/E/pub/qi/qi-018/README.html>  
<http://www.cra-arc.gc.ca/E/pub/qi/qi-017/README.html> .

Members should be reviewing this material to gain knowledge of the rate reduction and the impact. As well, clients can be referred to these resources.

## **HAVE YOU SEEN .....?**

A new issue of *CA Practice Advantage* (May 2006) is available and can be accessed at [www.capa@casource.cica.ca](http://www.capa@casource.cica.ca). This newsletter, published by CICA, highlights the latest trends and views, research, standards and regulations, IT, human resources, legal matters, recent publications and other information relevant to CAs in public practice, and is **free** to members.

The May issue includes articles and resources on topics such as:

- Building a continuity plan
- Managing a family owned business
- Preventing theft
- Helping employees feel valued

## **FINALLY..... HOW TO END A TAX SEASON!**

The following picture shows how one ICANS practitioner spent April 30<sup>th</sup> –



Waterskiing!

## **SUGGESTIONS FOR THE NEXT ISSUE?**

Contact **Wenda Bennett, CA** at the Institute [wbennett@icans.ns.ca](mailto:wbennett@icans.ns.ca) or (902) 425-3291.

## REQUEST FOR INPUT FROM THE IAASB EXTERNAL CONFIRMATIONS TASK FORCE

JUNE 2006

### BACKGROUND

The External Confirmations Task Force (ECTF) is conducting a project to revise ISA 505, *External Confirmations*, and ISA 501, Part C, *Procedures Regarding Litigation and Claims*. The project's primary focus is to review the circumstances when external confirmations are required and when they are not. The project initially will address the need, if any, to, and the practicality of, requiring confirmation of bank balances and related matters from banks and legal matters from law firms. Its secondary focus is to identify whether there is a need, if any, to amplify the standards and guidance in ISA 505.

In considering whether to mandate confirmations, one of the issues the ECTF is considering is concerns relating to the adequacy of confirmations as a reliable source of audit evidence. These concerns arose in discussions about the project proposal and also in a survey of national auditing standard setters (NSSs). The NSSs indicated that the quality of responses to bank confirmations and to legal confirmations is not high.

The ECTF is seeking to gain a clearer understanding about audit evidence issues relating to confirmations. In this respect, the ECTF is not only considering bank and legal confirmations but also accounts receivable and other confirmations. The ECTF is seeking input from practitioners in different sizes of firms. Input received will assist the ECTF in making recommendations to the International Auditing and Assurance Standards Board with respect to the scope and direction of the project.

**PLEASE RESPOND TO [ERIC.TURNER@CICA.CA](mailto:ERIC.TURNER@CICA.CA) ON OR BEFORE JULY 14, 2006. IN RESPONDING TO ERIC, PLEASE PROVIDE THE FOLLOWING INFORMATION:**

NAME  
ORGANIZATION  
EMAIL ADDRESS  
TELEPHONE NUMBER

### QUESTIONS FOR PRACTITIONERS

**(In responding to the following questions, we would be grateful if you could consider them in the context of a broad range of confirmations – legal, bank, accounts receivable, accounts payable, etc. The ECTF are particularly interested in knowing when your answers are different for bank confirmations and/or legal confirmations as compared to other confirmations.)**

#### Practical issues of the confirmation process

The following is a rough outline of the auditor's confirmation process:

1. Identify the assertions to be tested by external confirmations as substantive procedures
2. Design confirmation requests (positive/negative/blank field confirmation, form of request, information to be confirmed, etc) and identify the appropriate third party respondents
3. Maintain control over the process of selection of respondents, preparation of confirmations, sending requests and receiving responses
4. Perform alternative procedures with respect to non-responses (including "unable to confirm" responses), responses with differences and unreliable responses
5. Evaluate the sufficiency of audit evidence obtained regarding the assertion being audited
6. Perform roll forwards as required

- A Which steps in the audit confirmation process do auditors often not perform well?  
Why?
- B Are there any factors specific to different sizes/types of client that affect, either positively or negatively, on auditors' ability to perform the audit confirmation process?
- C (Deleted)

## Confirmations as a source of evidentiary value

An underlying presumption of the use of confirmations is that confirmation from a third party provides greater assurance than evidence obtained solely within the entity. The audit risk model indicates that when the auditor assesses risk to be high (including significant risks), more relevant and reliable audit evidence is sought. They also indicate that confirmation may be used to provide sufficient appropriate audit evidence in such circumstances.

There may be different factors affecting the assurance that an auditor obtains from a confirmation, such as:

- The nature of the account being confirmed
- The design of the confirmation request
- The person to whom the request is sent
- Whether the confirming entity has a policy, the resources and a process, for responding to confirmation requests

- D Of the following, what do you consider to be the most appropriate response?
- (a) We always use confirmations because they provide reliable audit evidence
  - (b) We use confirmations to address the need for more reliable audit evidence in higher risk situations
  - (c) We use confirmations because standards require them; we have no choice
  - (d) It's established good audit practice, so we routinely obtain confirmations on all audits regardless of risk assessments, but we don't place reliance on them
  - (e) None of the above (please explain)
- E What are the key factors affecting whether confirmations provide greater assurance than other types of substantive procedure?
- F Are any of these factors particularly prevalent with respect to smaller or larger clients?
- G What types of errors are found in confirmation responses and what do you determine to be the root causes of these errors?
- H Under what circumstances do you consider that other substantive procedures provide as much, if not more, assurance than confirmations?

## Mandating confirmations

In considering the issue of mandating confirmations, the ECTF would be interested in any practical implementation issues that it would have to address.

- I What issues do you envisage, if any, were confirmations (particularly bank and legal confirmations) to be made mandatory?
- J What would you see as possible exceptions to mandatory confirmation, if any, that the ECTF would need to consider?