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# THE PRACTITIONER'S VIEW

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Vol. 5, Issue 6 Aug 2004

## ACCOUNTING and ASSURANCE STANDARDS - UPDATE

*CAmagazine's* August 2004 issue included a summary of all accounting and assurance standards issued from May through August 2004, as well as a list of all documents for comment outstanding as at August 2004. Standards issued include:

<b>CICA Handbook – Accounting</b>	<b>Effective Date</b>	
Amendments to Exchangeable Debentures, EIC-56	Beginning	July 1, 2004
Basis of Accounting for Assets Acquired Upon the Formation of an Income Trust, EIC-145	Beginning	January 1, 2004
Flow-Through Shares, EIC-146	Beginning	March 19, 2004
Implementation of Accounting Changes Resulting from the Application of CICA 1100, EIC-147	Beginning	April 19, 2004
<b>CICA Handbook – Assurance</b>		
General Standards of Quality Control for Firms Performing Assurance Engagements, GSF-QC*	On	December 1, 2005
Quality Control Procedures for Assurance Engagements - Section 5030*	Beginning	December 1, 2005
* See accompanying article		
<b>CICA Public Sector Accounting Handbook</b>		
Amendments to Government Reporting Entity, Section PS 1300	Beginning	April 1, 2008
Funds and Reserves, PSG-4		June 2004
Financial Statement Discussion and Analysis, SORP-1	n/a	

## ACCOUNTING STANDARDS: FUTURE DIRECTION – HAVE A VOICE

Significant decisions on the future of accounting standards in Canada will be taken in the next few months. The Accounting Standards Board is seeking your views to help shape that future and serve the best interests of users. Some of the issues under discussion include the following:

- With the increasing globalization of the world economies, particularly for investors and capital flows, what role, if any, should Canadian accounting standards have?
- Does harmonization with US GAAP inevitably result in US-style detailed rules?
- What role, if any, should Canadian standard-setters play in the development of high-quality internationally accepted accounting standards?

A roundtable discussion is being planned for September 10, 2004 in Halifax commencing at 8:30 a.m. Please send an e-mail to [florita.dinglasan@cica.ca](mailto:florita.dinglasan@cica.ca) indicating your intention to attend and provide brief contact details.

Further details, including a discussion paper and links to background information may be obtained from the Accounting Standards Board's website at [http://www.acsbcanada.org/index.cfm/ci\\_id/21832/la\\_id/1.htm](http://www.acsbcanada.org/index.cfm/ci_id/21832/la_id/1.htm).

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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.*

## NEW ASSURANCE STANDARDS ON QUALITY CONTROL

The following article appeared in the Summer 2004 issue of *CheckMark*, a publication of the Institute of Chartered Accountants of Ontario and is reprinted with the permission of ICAO.

The Auditing and Assurance Standards Board (AASB) electronically published two new standards in August 2004:

*General Standards of Quality Control for Firms Performing Assurance Engagements* (referred to as the "Firm standard"), and *Quality Control Procedures for Assurance Engagements, CICA Handbook — Assurance Section 5030* (referred to as the "Engagement standard").

The intent of the standards is to meet the heightened expectations of both regulators and the general public for quality performance in the completion of audit and other assurance engagements. Stakeholders expect the public accounting profession in Canada to take a leadership role in demonstrating that quality is a core element of assurance engagements. Implementation of new comprehensive quality control standards is a clear response to that public expectation.

Canada is not placing a unique demand upon its public accountants. Earlier this year, the International Auditing and Assurance Standards Board published new international quality control standards. The Canadian standards have been harmonized with these new international standards, so that practice in Canada will be consistent with that of other countries, including the United States.

It is also important to note that the new quality control standards complement the rules of professional conduct related to independence recently implemented in Canada and internationally. The AASB has taken care to determine that the final standards do not impose requirements that go beyond those of the independence rules (for example, the rules relating to rotation).

The *Firm standard* has been published in the *CICA Handbook — Assurance*; while separate from the assurance standards, it nonetheless forms part of generally accepted standards of practice of the profession. This is consistent with the positioning of the material in the authoritative guidance provided in other western countries — done to ensure that the standard does not fall within generally accepted auditing standards and potentially expose a firm to unwarranted liability.

The *Engagement standard* is included in assurance standards. The two standards clearly distinguish between the responsibilities of a firm with respect to establishing a system of quality control and the responsibilities of the practitioner (partner) and others performing an individual assurance engagement. Assurance standards deal with the performance of individual assurance engagements and, as noted in new quality control standards, it is possible for a practitioner to have complied with assurance standards for an individual engagement even if there is a deficiency in the firm's system of quality control. Consequently, the *Firm standard* is a self-standing document outside assurance standards. This has resulted in a need to address, in the *Firm standard*, matters that are also dealt with in the *Engagement standard* and other assurance standards, such as planning, supervision and review.

The AASB firmly believes that the Recommendations and the underlying principles set out in the final standards are necessary and appropriate, and can be applied to assurance engagements in firms of all sizes. The AASB recognizes, however, that implementation of the new standards may have a significant impact on many firms, and this impact may vary depending on the size of firm or the extent of existing processes within firms. To help ensure that the standards will be implemented appropriately, the AASB has taken the following steps:

- The effective date of the standards has been deferred from the date proposed in the *Exposure Draft* (January 1, 2005) to December 1, 2005 to allow practitioners more time to prepare for implementing the new standards. The one exception, however, is for those firms registered as participants with the Canadian Public Accountability Board (CPAB). These participating firms are required to implement the new standards as of January 1, 2005.
- To respond specifically to concerns expressed by small and mid-size firms, **implementation guidance is being developed, and is expected to be published by the CICA in the fall of 2004**. This guidance consists of a *Quality Control Manual* (the Manual), based largely on the material developed by the Greater Vancouver Mid-Size CA Firms Forum. Although the Manual was developed based on a model for a mid-size firm, material will be added to address issues that are specific to smaller firms and sole practitioners. This Manual, which will complement the *Practice Engagement Manual*, will contain detailed guidance, forms, templates and checklists that practitioners can readily adapt to their own circumstances.
- There will be communications designed to help practitioners understand and implement the new standards. These communications will touch on such matters as the use of external consultants, the nature of an

engagement quality control review, monitoring and inspection. For example, watch for an article in *CAMagazine* in November 2004 and further articles on the Institute's Web site.

- The AASB is confident that, with the practice guidance and an enhanced communications effort, the new standards can be implemented effectively. In doing so, the public accounting profession will be able to demonstrate that it is firmly committed to a uniformly high quality of work.

For more information on these new standards, contact either of the following CICA assurance staff: Don Jeffreys, CA, at don.jeffreys@cica.ca, or (416) 204-3232, or Jacqui Bridel, CA, at jacqui.bridel@cica.ca, or (416) 204-3445.

## EIC-122 BALANCE SHEET CLASSIFICATION 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 not always been handled properly – **it is not appropriate to provide additional disclosure regarding the demand nature of the debt without reclassification.** If the debt is not reclassified, the assurance report should be appropriately qualified.

Whether you agree or disagree with the CICA Handbook Recommendations, **adoption of standards is not optional.** Lending institutions and other users of the financial statements are rightfully confused to wonder why the same situation is treated differently from firm to firm.

## DETECTING FRAUD AND ERROR - PROFESSIONAL SKEPTICISM

In April, the Auditing and Assurance Standards Board (AASB) issued a revised *Handbook* Section 5135, The Auditor's Responsibility to Consider Fraud and Error, **effective for 2004 calendar year-ends.** Significant changes were also made to Section 5190, Audit of Financial Statements – An Introduction, primarily to remove references to the auditor's assumption of management's good faith.

These new standards will require an important mindset change that cannot be overemphasized – a significant extension of the auditor's role. **Simply updating audit manuals and using revised checklists will not suffice.** For an in-depth look at the new requirements, see *Detecting Fraud and Error*, *CAMagazine*, August 2004 issue, at [http://www.camagazine.com/index.cfm/ci\\_id/22173/la\\_id/1.htm](http://www.camagazine.com/index.cfm/ci_id/22173/la_id/1.htm). The June 2004 issue of *Focus on PEM* newsletter also highlights the changes to these Sections and discusses the impact on audit engagements. (Also refer to an article in the May 2004 issue of *The Practitioner's View*)

The CICA is developing a fraud resource on the Knotia part of its website. Until the resource is fully developed, auditors may refer to the AICPA's Anti-Fraud Resource Center at [www.aicpa.org/antifraud/homepage.htm](http://www.aicpa.org/antifraud/homepage.htm).

## CATCH THE WARNING SIGNS OF FRAUD IN NPOS

*"Fraud" is a buzzword for accountants these days from both an assurance and professional liability perspective. The May 2003 issue of CARM, a risk management newsletter published by AICA Services Inc., included an article "Fraud Claims on the Rise", which addressed the magnitude of the problem for small/owner-managed businesses and non-profit organizations. The article identified red flags and preventative measures and is worth a re-read. The Journal of Accountancy, in its January 2004 issue, from which the following article has been reprinted, also highlighted this problem and recognizes additional red flags, pertaining specifically to NPOs.*

With their high fund-raising and performance goals and with volunteers often handling money and keeping accounting records, nonprofit organizations can be prime targets for fraud. Here are some of the red flags CPAs can advise NPO employers and clients to watch for:

**Budget cutbacks.** Whenever any organization - especially an NPO operating on fund-raising dollars and volunteer leadership - cuts back by reducing its paid workforce, financial controls usually suffer. Remaining employees or unpaid volunteers must pick up the slack. This can lower morale and increase the likelihood of fraud among unhappy workers.

**High turnover.** When NPO volunteers and employees turn over faster than elected positions or job contracts dictate, it could be a sign people are distressed by committing or witnessing fraudulent activity or by being coerced into participating in it. Many guilt-ridden, frustrated bystanders or the fraudsters themselves decide to leave an organization altogether.

**Refusal to take legitimate perks.** When employees or volunteers are involved in an ongoing embezzlement scheme, they often don't take vacation time or offered promotions so they can continue to hide their theft.

**Overemphasis on short-term fund-raising goals.** When board members, officers or executives become too concerned with increasing contributions, they often de-emphasize internal controls and accurate financial reporting, leaving room for fraudsters to step in.

**Poorly monitored remote event or promotional locations.** Fraud often proliferates wherever supervision and control are at a minimum - such as during major fund-raising events such as benefits. This is particularly true when organizations - acting without proper accounting supervision - fail to create a paper trail with prenumbered tickets, receipts and the like. When cash is involved, it's always a challenge to determine who took how much from the cash drawer after the fact.

**Bounced checks.** If the NPO's board of directors knows the organization has enough funds to cover its expenditures and checks continue to bounce, chances are good the entity may be a victim of some kind of fraud.

**Things don't add up.** If staff members or volunteers are working on the organization's books and things don't make sense, CPAs need to take a closer look. Employees or volunteers may be stealing payments and diverting them to their accounts as they come in.

**Anonymous tips.** Fraud warnings can come in the form of telephone messages or anonymous letters from employees or volunteers. While they sometimes may be frivolous and without merit, NPOs can't afford to ignore them.

**Lifestyle or behavior changes.** An obvious discrepancy between an employee's earnings and how he or she lives can be a red flag for fraud. If a person's behavior suddenly changes, he or she may be under severe pressure because of fraudulent activity.

**Inattention to details.** An organization that doesn't check account balances daily and reconcile bank statements immediately is inviting embezzlement. NPOs that don't employ other controls, such as scanning paid bills for possible overpayments, spot-checking financial records without advance warning and reviewing mail before it is opened, also are inviting trouble.

**Not conducting background checks on anyone handling money.** This is especially true for volunteers, who NPOs frequently don't scrutinize as closely as employees.

**Keeping problems a secret.** If an NPO doesn't make a strong public statement about fraudulent activities when it discovers them, it leaves itself open to further violations by others who think the act went unpunished or unnoticed.

**Failing to investigate and then prosecute to the fullest extent of the law.** An organization that doesn't conduct a full investigation to understand the fraudster's methodology, the total amount of the loss, how it occurred and how to prevent it in the future can easily be defrauded again—in exactly the same way. Where appropriate the NPO should contact authorities and cooperate fully in a prosecution so employees and volunteers understand fraudsters will be punished.

## **RULE 204 - INDEPENDENCE QUESTIONS AND ANSWERS**

Earlier this year, ICAO Institute staff and volunteers made presentations across Ontario on the new independence Rule 204 and encouraged members to submit questions. Some of the questions received (which mirror those of our members), together with responses prepared by Institute staff, are included in an article reprinted in **Appendix A**. These responses are intended to assist members in gaining a thorough understanding of Rule 204.

## IT'S "JUST" AN NTR

The following article appeared in the June 2004 issues of *News 'N Views*, a publication of the Institute of Chartered Accountants of British Columbia and is reprinted with the permission of ICABC.

Have you ever said, "it's just a Notice to Reader" to a staff member when assigning an engagement? Or heard it when discussing review notes on a file? Well, you probably never said it to, or heard it from, a client.

Recently, we've heard that many firms are recommending that clients "downgrade" from review engagements to compilation engagements. This suggestion is advanced primarily in response to ever-more complex accounting and disclosure requirements, and stems from a desire to contain costs by not expanding work to comply with the new standards. Many clients agree to the suggestion based on the perceived opportunity to curb professional fees.

However, members and firms are aware that few clients actually read the report attached to the financial statements, and that the relationship between client and CA is primarily based on trust. Most clients are largely unconcerned with the details within the financial statements particularly those contained in the notes to the statements. They are, however, extremely concerned about the underlying numbers and accounting. They expect them to be correct. "If my CA did the work, it must be right."

Accordingly, we suggest that members and their staff take the necessary care to ensure that the accounting and records behind a compilation engagement are accurate and complete. Clients expect no less!

## NEW GUIDANCE FROM PSAB

If you do any work for the federal, the provincial, or a territorial government, you should be aware that the Public Sector Accounting Board has issued standards setting out a new reporting model to be used for all reporting years commencing on or after April 1, 2005. You can visit the CICA's website to download more information about the model and a booklet entitled "**20 Questions About Government Financial Reporting**" to help you explain the new standards to your clients: [http://www.cica.ca/index.cfm/ci\\_id/18656/la\\_id/1.htm](http://www.cica.ca/index.cfm/ci_id/18656/la_id/1.htm).

The booklet is a good introduction for taxpayers, elected officials and media to make government financial statements more understandable. It includes a section that contrasts and explains the accounting and reporting done by a business and that done by a government; it also explains what "PSAB" and "GAAP" are, and why governments should follow GAAP.

## CICA OFFERS ONLINE COURSES – FREE!

The CICA currently offers online courses to members on privacy and e-business. The E-Biz is Good Biz Level 1 Certificate course is available free to CAs only. (It normally retails for \$79.) [Click here for more information.](#)

PS - You will need your CICA Membership number to log on - you can find it on the label of your CAmagazine, or on invoices from the CICA ... or you can email ICANS ([skeramaris@icans.ns.ca](mailto:skeramaris@icans.ns.ca)) and we'll send it to you. Your membership number consists of the letter 'C' plus six numbers. i.e. C123456.

## PRACTICE MANAGEMENT ISSUES

You are well aware that the current state of the profession has been assessed and a strategic plan is being developed for the future. Is it time for your firm to follow suit? If so, the following articles may be useful references:

- **The Aging Practice** - Recovering lost energy, *CAmagazine* (May 2004)  
"How does one overcome the difficulties presented by new legislation, greater standards, market pressures of services and increased demands from clients that you demonstrate the delivery of value and benefits?" (sound familiar?) Also included is a self-assessment checklist.  
[http://www.camagazine.com/index.cfm/ci\\_id/20892/la\\_id/1.htm](http://www.camagazine.com/index.cfm/ci_id/20892/la_id/1.htm).

- **Who Will Take the Reins?** *Journal of Accountancy* (August 2004)  
Long-term survival of the firm is explored in this article, which also includes tips on developing existing staff and a Career Counselling Guide (vs the "annual review").  
<http://www.aicpa.org/pubs/jofa/aug2004/wein.htm>.

## REMINDER – PROFESSIONAL LIABILITY INSURANCE DECLARATION

Forms for the annual declaration of insurance coverage, mailed in July, are to be completed and returned to ICANS by September 1, 2004. If you require another copy of the form or have questions about completing it, please contact Wenda Bennett at [wbennett@icans.ns.ca](mailto:wbennett@icans.ns.ca).

## 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.



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## APPENDIX A

### RULE 204 - INDEPENDENCE QUESTIONS AND ANSWERS

*The following article appeared in the Summer 2004 issues of CheckMark, a publication of the Institute of Chartered Accountants of Ontario and is reprinted with the permission of ICAO.*

Earlier this year, Institute staff and volunteers made presentations across Ontario on the new independence Rule 204 and encouraged members to submit questions. Here are some of the questions received, together with responses prepared by Institute staff. These responses are intended to assist members in gaining a thorough understanding of Rule 204. Although the responses have been carefully prepared and reviewed by Institute staff, the responses are not official positions of the Institute. Members may seek the views of the Professional Conduct Committee on the application of Rule 204 to their particular circumstances by writing to Joanna L. Maund, FCA, Director of Standards Enforcement.

**Q:** When does Rule 204 take effect? Provide some examples to illustrate the effective dates.

**A:** Rule 204 is effective for reporting periods commencing after December 31, 2003. It is therefore in effect for a reporting period of January 1, 2004 to December 31, 2004, and subsequent periods. However, it is not in effect for any reporting period that commenced in 2003.

**Q:** I have been a sole practitioner for 20 years. Many of my clients have been with me for a long time, some for over 15 years. My practice is in a rural community and the next CA office is a two-hour drive away. I have two technicians on staff and a receptionist. My clients rely on me as their trusted financial advisor. To say the least, I am very familiar with my clients. There are a few that I socialize with on a regular basis and some are close friends. In fact, our families vacation together. Given the circumstances, is there a familiarity threat to my independence and, if so, what practical safeguards could you recommend that would reduce this threat to an acceptable level?

**A:** There is no simple answer to this question as threats to independence are often about perception. Socializing with clients is usually not a problem unless the practitioner is seen together with the client so often that the rest of the community views the member as becoming too close to the client and the relationship as no longer being on just a professional level.

The member should document the identification of threats to independence created by a long association with clients. Safeguards that might be appropriate for reducing any threat to independence to an acceptable level include:

- Consulting with another professional accountant or Institute practice advisor; and
- Provincial practice inspection.

Paragraph 97 of the Council Interpretation states that a threat to independence may exist when there is a close relationship between the member and the client. The evaluation of the significance of the threat and the availability of safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering the closeness of the relationship. In making this evaluation the member should consider whether a reasonable observer would believe that independence in appearance was impaired.

**Q:** My client asked me to prepare payroll cheques based on the time cards he provides. Does the preparation of payroll cheques create a self-review threat?

I perform a review engagement for this client and management generally signs the cheques. Would there be a problem if I occasionally co-signed the cheques – such as when one of the regular cheque signers is on vacation?

**A:** The preparation of payroll cheques based on time of records prepared by the client would not be in breach of Rule 204.4 (23); however, providing such services to an audit or review client may create a self-review threat to independence. Paragraph 140 of the Council Interpretation provides that a member may perform payroll services that do not involve having custody of client assets for an audit or review client as long as any resulting self-review threat is reduced to an acceptable level. Safeguards that could be applied to reduce the self-review threat to an acceptable level include:

- Obtaining formal management approval of time records;
- Ensuring the payroll cheques are signed by management; and
- Assigning the payroll preparation duties to a person who is not on the review engagement team.

Signing of cheques is a management function and in most organizations is a major step in the approval of transactions. Rule 204.4(22)(a) prohibits a member from performing an assurance engagement if, during the engagement period, a member of the firm performs a management function. Accordingly, a member should never sign cheques for a review client.

**Q:** How should I obtain management approval of journal entries?

**A:** There are two broad principles underlying the requirement to obtain management approval. The first is that the financial statements are the client's responsibility, not the member's. Secondly, the member cannot be objective when providing assurance on his or her own work (the self-review threat). In order for the member to express a conclusion, all components of the financial statements must be subject to a level of independent scrutiny that meets the standards of the profession, not just those portions that have been prepared by the client. Therefore, although the member may assist the client by preparing journal entries, the client must accept responsibility for those entries and their effect on the financial statements.

The best way to accomplish this is to discuss each journal entry with the client - explaining the rationale behind it and describing how it impacts the financial statements - and then ask for client approval. This approach fosters a better understanding between the client and CA and helps develop a solid client relationship. It does take some extra time and there may be billing issues related to that extra time that will need to be addressed with the client. However, members should keep in mind that considerable value may be attached to the goodwill created by such discussions. A face-to-face meeting with the client that includes client sign-off on the journal entries is the most effective way to obtain approval of those journal entries.

Some other ways of dealing with the self-review threat presented by the preparation of client journal entries might include:

- Outlining the entries and their effect on the financial statements as part of the management representation letter. Client approval can be evidenced by the client's signature on that letter;
- Providing training to client staff so that the entries can be prepared by them; and
- Considering if the use of a separate bookkeeper to prepare such entries might prove to be more cost-effective (for both the client and the CA).

**Q:** We prepare forecasts for our review clients to assist them in their borrowing requirements. What is now required under Rule 204 that wasn't required under the old Rule 204?

**A:** Preparing a forecast for a review client may create an advocacy or a self-review threat to independence. As is the case when providing bookkeeping services to a client, a member should review the forecast carefully with the client and ensure that the client accepts responsibility for all aspects of the forecast, including the assumptions upon which the forecast is based. Further, when accompanying a client to present the forecast to the bank, the member's involvement must be restricted to explaining the forecast to the banker. Refer to paragraph 187 of the Council Interpretation.

**Q:** My question relates to unpaid fees from prior engagements. What documentation is required to show that a threat is insignificant?

**A:** The member should document the identification of the threat to independence posed by unpaid fees and the reason(s) for the member's conclusion that it is insignificant. Factors to consider include:

- Percentage of the member's total fees derived from the particular client;
- Client's previous payment pattern;
- Percentage of prior years' total fees that are outstanding when the report is issued; and
- Any unique or non-recurring circumstances the client is currently facing.

A brief paragraph in the working papers documenting the matters considered should be sufficient.

**Q:** Rule 204.4(7) includes a reference to a “professional employee”. Who is a professional employee of the firm?

**A:** A professional employee is any employee who provides professional services to a client. An administrative assistant (receptionist, financial statement typist, office manager, etc.) is generally not considered to be a professional employee.

With respect to Rule 204.4(7), if an employee who is not a professional employee owns more than 0.1 per cent of the shares of a client, the firm is not prohibited from performing an audit or review engagement. However, the firm must still consider whether the employee’s interest in the client creates a threat to its independence, and if it does, safeguards must be applied to reduce the threat to an acceptable level.

**Q:** One of the potential safeguards described in the Council Interpretation is obtaining the views of, or having the work reviewed by, another professional accountant. Must this person be a CA?

**A:** There is no requirement for this person to be a CA. However, the person should have sufficient technical knowledge of the subject matter and of the independence rules to provide an effective safeguard.

**Q:** I perform a review engagement for a company that owns a rental property. I prepare an occupancy cost report, calculate the balance due by tenant, and have the client approve it. Can I then send a letter to each tenant advising of the balance due and the revised occupancy fee or does the client have to send this letter? Would this letter be considered a source document?

**A:** Generally, preparing an occupancy cost report and calculating the balance due by each tenant would not create a threat to independence, provided the client approved these documents. However, sending a letter to the tenants advising them of the balance due and revised occupancy fees could be interpreted as a management function and may jeopardize the practitioner’s independence, particularly if the practitioner was responsible for collection of moneys owed by tenants and/or resolution of disputes. Accordingly, the client should send these communications to the tenants. The client should also handle all collections and resolve all disputes.