



THE PRACTITIONER'S VIEW

Vol. 3, Issue 2
Jan 2002

SURVEY SAYS WE'RE DOING GREAT!

An extraordinary 100% of those who responded to

the reader's survey of The Practitioner's View (13%) gave a resounding "yes" to continuing the publication, with 91% indicating it has high relative value to them.

We were troubled, however, that 38% were not aware that the newsletter is also posted on our website; when combined with other requests for information which also is available on the website, we realize we have further communicating to do.

UPDATE ON CIVIL PENALTIES

CCRA has now released the final administrative guidelines on third party civil penalties. Information Circular 01-1 Third Party Civil Penalties, released on October 2nd, sets out the process by which the CCRA will apply these penalties and offers suggestions to practitioners as to how to minimize the risk of penalty. A copy of these guidelines can be accessed directly on the CCRA website at www.ccrardc.gc.ca/formspubs/technical/penalties-e.html.

The CICA's submissions on the earlier draft guidelines focused on the members' concerns that the proposed guidelines would result in a wider application of the penalties than was ever intended by the Department of Finance or expected by our members. The CICA believes that some changes have been incorporated within the final administrative guidelines that help address members' concerns. For example, the introduction to the final guidelines notes the intention that these penalties be applied to egregious situations. As well, the guidelines include new references to turning a blind eye to false information provided by clients, which helps narrow the focus somewhat.

However, there are still a number of areas where the CICA believes that the interpretation of the guidelines may cause unintended results. They would like members to inform their Institute of any application of civil penalties in situations that members may consider are inappropriate and not in keeping with the intent of the legislation.

At the same time, there are concerns about the implications for the profession regarding the levels of research and documentation that could be necessary under the new

penalty regime. This points to the need for tax practitioners to review their procedures against some of the requirements that are outlined in the guidelines.

TAX SELF-HELP GROUPS

A group of general practitioners in the Metro area get together to discuss tax issues on a regular basis. Monthly meetings include reviewing tax videos available from Alberta and exploring areas of concern.

If you live in the area and are interested in joining the group, or want guidance on starting a similar one in your part of the province, contact David Yuill, Chair of the Practitioner's Committee, at 864-5540.

IS THE HST BALANCE REASONABLE?

Your client calls and states the following: " I have an HST auditor with me and he says that I owe an extra \$80,000 in tax! What should I do? I see that you signed this page called a Review Engagement Report. Aren't you supposed to check whether I am calculating the HST properly? "

Hopefully, this does not sound familiar. What steps do you as a practitioner take to prevent such situations arising in your practice?

1. First and foremost, it is always necessary to ensure that the client is aware of your responsibility for such matters as compliance with HST and other types of statutory remittances. While this should take the form of a frank and open discussion of what an audit or review engagement is expected to entail, it is important to document the matter in your engagement letter or other correspondence. Once the client has been HST audited is not the ideal time to discuss your potential liability!
2. Secondly, it is important in understanding the client's business to determine whether the client has competent individuals who understand the basic requirements associated with such remittances. Often, this takes the form of simply identifying the person responsible for handling such transactions, and then determining his or her basic knowledge of the requirements. If you determine a need, you may wish to advise the client of the potential risk, and suggest an appropriate solution. This may lead to additional value-added fees, as you work with the client to establish an appropriate system or source of training. Again, documentation is beneficial.

3. Finally, you may wish to review the basic steps you take in performing the audit or review regarding the statutory remittances. Assuming you are performing a review engagement, do you simply check that the year-end HST balance agreed to the remittance report and that the balance was in fact paid after the end of the company's year? If so, have you really proven that the HST liability is plausible and reasonable?

One practitioner has suggested the minimum following procedures should be part of your regular procedures:

- Starting with the balance at the beginning of the year, add 15% of the sales per the income statement, as well as sales of capital assets, and deduct 15% of the expenses that should have attracted HST. Also, ensure that you deduct HST on capital additions. Next, the payments made to the CCRA during the year for HST are deducted, resulting in the estimated balance payable or receivable. If your result is significantly different from the client's recorded balance, then have the client help you to determine the reasons for the discrepancy.
- If the client is a registered charity, or a government funded non-for-profit organization, the test is even easier. Simply estimate the expenses from the income statement, as well as the capital additions that would be subject to HST and reduce them by 7.5/107.5. Then, calculate 7.5% tax on the balance and compare your result to the HST rebates calculated by your client.
- It is also not uncommon that the preparation of the year-end identifies additional adjustments, after the year-end return has been filed. Often there are additional material liabilities related to the sale of capital assets. The accountant adjusts the records and the financial statements are correct; however, the client never reports the amount on an HST return and therefore has not remitted the required payment. Consideration should also be given to ensuring (and documenting) that prior year adjustments have appropriately flowed through to the HST return.

Unfortunately, the HST, like its predecessor, the FST, has many quirks with its rules. Some of the more common traps include the following:

- Purchase of capital equipment and supplies from non-participating provinces
- Sale of goods and services in non-participating provinces
- Change-of-use and mixed use properties
- Companies that have some exempt activities
- Purchase or sale of real estate, especially vacant land
- Imports and exports

However, as you complete the HST reasonableness test annually, you will quickly become much more familiar with the effects of these rules on your client. Sometimes, you will even find changes in your client's favour. At the very least, you will be able to properly answer the question, "Is the HST balance reasonable?"

ICANS SCORES A WIN IN REAL ESTATE DEAL!

In the Fall Session, the government introduced Bill 85 to amend the Real Estate Trading Act to essentially give the Real Estate Commission significantly more enforcement powers against non-licensed individuals who breach the Act. Recent issues of the *View* cautioned practitioners that CAs who assist their clients in acquiring or disposing of businesses could inadvertently be in violation of the Act.

While ICANS was not aware of Bill 85 until it passed first and second reading on two successive days in the legislature, the Bill was seen as an excellent opportunity to provide greater assurance that CAs were not unfairly caught by the enhanced enforcement provisions. As a result of a flurry of communication with various government officials and two separate appearances before the Law Amendments Committee, ICANS was successful in having the Bill amended to provide an exception from the Act for public accountants who assist clients as part of their practice of public accounting. The exception reads as follows:

(ca) any person who is licensed by the Public Accountants Board of the Province of Nova Scotia and whose license is in good standing and the trading is in the course and as part of that person's practice as a public accountant;

This new exception should be viewed as a big improvement over the previous situation and is especially welcome considering the fact that the Real Estate Commission chose to speak against an exception at its appearance before the Law Amendments Committee.

Members are cautioned to be aware of the provisions of the Real Estate Trading Act, however, and reminded that those members who wish to actively trade in real estate or businesses should take the necessary steps to be licensed as real estate traders. Copies of the amended Act which was enacted on November 22, 2001 can be found on the government website at www.gov.ns.ca.

AUDITOR'S STANDARD REPORT CHANGED – ANOTHER REMINDER

Effective March 2001, the CICA Handbook was amended to reflect the requirement for assurance engagement reports to identify Canadian practices as the basis for the report. The new required wordings are "Canadian generally accepted auditing standards," "Canadian generally accepted standards for review engagements," and "Canadian generally accepted accounting principles." Members are reminded to amend their financial statement templates to reflect these changes.

PRACTITIONERS EVENTS

Practitioners turned out in record numbers for the annual Golf Day this year in September and also for the Practitioner's Forum in October. Once again Truro hosted both events and based on feedback, members continue to find meeting outside the Metro area convenient.

Plans are already underway for next year's session; if you have any topics that you'd like to see on the agenda, please contact Soula Keramaris at the Institute.

PROFESSIONAL LIABILITY – MANAGING YOUR RISK

Malcolm D'Souza, Claims Manager for AICA Services Inc., gave a presentation at the Practitioner's Forum on managing your professional liability risk. He reminded members that it is better to call early than late about a potential claim. If it is too early, the adjusters will tell you so. If it is too late, you may end up without coverage. *Calling too early will not affect your premiums.* Malcolm offered the following tips to avoid claims:

- Attend loss control presentations.
- Document.
- Don't get in over your head.
- Choose your clients carefully.
- Identify clearly engagement terms with your clients.
- Ensure procedures are in place to control quality of work provided.
- Consider strongly before proceeding with a fee claim as these usually result in counterclaims.

A Risk Management Seminar held in BC in May 2001 also included lawyers and a forensic accountant as speakers on this topic.

One lawyer reviewed several recent decisions relating to accountant's negligence and provided a list of "ten commandments" for members to keep in mind:

- Sell the firm fairly.
- Educate the client and record it.
- Obtain engagement letters.
- Stay within your realm.
- Plan and coordinate the work.
- Keep the client informed.
- Deal with problems promptly.
- Record conversations.
- Verify representations.
- Avoid suing for fees.

The forensic accountant reviewed the role of auditors in the detection of fraud. He presented the following factors of why auditors fail to detect fraud:

- Lack of knowledge of the client's business.
- Lack of professional skepticism.
- Ignoring human element.
- Not understanding fraud.
- Ignoring red flags.

- Not developing fraud awareness mindset.
- Failing to examine source documents critically.
- Failing to do independent checks.
- Not pursuing discrepancies because they are "not material".
- Not enough time.

RECORD RETENTION FOR TAX ELECTIONS

This article, reprinted from the BC Institute's October newsletter to practitioners, provides useful advice to pass along. The reference to rule 218 is also the same for Nova Scotia. (Rules and Council Interpretations are available on the web at www.icans.ns.ca.)

Members and firms frequently prepare assorted "tax elections" on behalf of their clients. Such elections are usually for clients with more sophisticated requirements. The necessary file support for such elections is retained in accordance with Institute and insurance requirements. The Institute requirements are set out in Rule of Conduct 218 and the related Council Interpretation. Such tax elections may have a very long life and are often retained indefinitely.

We remind members and firms that the 1994 Capital Gains Election would fall into the "tax election" category with the corresponding file retention issue. When considering file retention for old T1 client files, it may be prudent to extract the documentation related to the 1994 Capital Gains Election and retain it in a file for all such elections. The remaining file contents could then be considered in accordance with usual practice.

PRACTICE REVIEW – WHAT SHOULD YOU BE CONCERNED ABOUT?

FINANCIAL STATEMENT PRESENTATION

The most common findings from this year's reviews relate to financial statement presentation by not-for-profit organizations. CICA Handbook Section 4400 came into effect in 1997 and many practitioners have adopted the recommendations. However, some have not implemented this Section for a variety of reasons:

- The financial statements are filed with a government department, which has its own guidelines;
- The recommended changes in format and presentation would not be easily understood or considered useful by the client and amount to "form over substance";
- The organization is very small; and
- It is difficult to recover audit fees for this type of client without the cost of additional disclosure.

At the present time, Section 4400 is in effect, and the current Exposure Draft on Differential Reporting (Big GAAP/Little GAAP) does not extend to not-for-profit organizations. While most practitioners agree the

recommendations should apply to larger NFP's, materiality related to the size of an organization must not be a determining factor in compliance.

The time required to revise financial statement presentation and provide required note disclosure for smaller NFP's would be minimal and occurs only in the year of adoption. Also, most practitioners consider the audit of this type of client to include an element of community service and, as such, low fee recovery is expected.

Many organizations, including condominium corporations, housing co-ops, nursing homes, etc., must file annual financial statements with a government department; yet, all are clearly defined as NFP's under Section 4400 and therefore are subject to the recommendations.

As a reference for the required changes, practitioners may be interested in viewing auditor's reports and financial statements including note disclosure for hospitals, health boards, museums, art galleries, etc., on the government's website at www.gov.ns.ca (click on "Departments", "Finance", "Public Accounts", "1999 Vol 2"). Another useful reference is the *Not-for-Profit Financial Reporting Guide*, published by the CICA.

Finally, *if* it is acceptable to report on "an appropriate disclosed basis of accounting" as outlined in Sections 5100.05, 5701.14, this must be clearly stated; otherwise the auditor's report cannot refer simply to GAAP or must be qualified.

AUDIT ENGAGEMENTS

The majority of audit engagements undertaken by members do not rely on the client's system of internal control. As a result, documentation of the following areas tends to be lacking:

- planning, including audit strategy;
- risk assessment (overall risk, inherent risk, control risk);
- knowledge of business; and
- the client's "control environment and control systems that collect, record and process data and report the resulting information" as required by CICA Handbook Section 5205.22.

Adequate documentation is still required for all areas, regardless of the size of the audit. Failure to document this area will generate practice review findings and may result in reinspection.

For further discussion and sample forms, practitioners may refer to the Professional Engagement Manual (PEM) as well as the audit technique study, *Audit of a Small Business*, published by the CICA. PEM audit forms that are particularly efficient for documenting the areas noted above are Inherent Risk Questionnaire (5.7), Inherent Risk by Financial Statement Assertions (5.8), Control Environment Questionnaire (5.9), and especially the Audit Strategy Memorandum (5.10). Also, the Summary of Significant Accounting Systems (7.1) is often used on smaller audits to

provide evidence that the auditor has a sufficient understanding of internal controls.

Another common finding that should be addressed is the documentation of analytical procedures to assist in evaluating the overall financial statement presentation upon substantial completion of the audit.

REVIEW ENGAGEMENTS

Documentation of review engagement files has improved over the last few years but is still weak with respect to:

- notes of discussions with the client concerning allowance for doubtful accounts, inventory count procedures and valuation, cut-off;
- reasons for significant variations from prior years results, including the balance sheet as well as the income statement (not limited to gross profit analysis); and
- contingent liabilities, contractual obligations, and review for subsequent events.

Documentation is not adequate if it is limited to signing off these steps as having been completed on the review engagement checklist; it should also include memos of the client's procedures and an assessment of their adequacy, indicating the individual with whom discussed and date.

In addition, there should be file evidence of knowledge of the client, planning, and the fact that the financial statements are in accordance with GAAP.

There is a good discussion of what constitutes proper analysis for both review and audit engagements in the April 2001 issue of *Focus on PEM*. The article titled "**When is Analysis – Evidence?**" includes a sample analysis of payroll costs for a law firm and shows how "plausibility" or "assurance" may be determined, depending on the type of engagement. It also points out why a straight comparison of the current year's to the prior year's figures may not be deemed "reasonable".

If you would like a copy of this article, please contact Wenda Bennett at wbennett@icans.ns.ca.

WHAT'S NEW FROM THE CICA?

EIC-122, issued October 31, deals with *Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced*.

Practitioners should note that where previously companies may have disclosed as long-term a "demand loan on which the bank is currently accepting monthly principal repayments", under the current EIC, all will be current.

SUGGESTIONS FOR THE NEXT ISSUE?

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