



Practice Advice

FOR CHARTERED ACCOUNTANTS PROVIDING REVIEW AND COMPILATION SERVICES

October 2006

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This CICA publication is an “other auditing and assurance publication” under the hierarchy established in *Authority of Auditing and Assurance Standards and Other Guidance*, paragraph 5021.02(d). It has not been adopted, endorsed, approved, disapproved or otherwise acted upon by the Auditing and Assurance Standards Board (AASB), any CICA board or committee, the governing body or membership of the CICA, or any Provincial Institute/Ordre. This publication has been prepared by the CICA Auditing and Assurance Standards staff to be included in the list of publications in Appendix B of Section 5021; consequently, it may be presumed to be appropriate. This publication may help practitioners understand and apply Recommendations and guidance issued by the AASB. Before applying the guidance in this publication, a practitioner should be satisfied that, in his or her professional judgment, it is relevant to the circumstances of the assurance engagement.

Practice Advice is written primarily for CAs who provide review and compilation services, but is not restricted to these CAs¹, and is intended to give helpful suggestions on performance and reporting issues. The content of this bulletin is based on recommendations from practice advisors and findings from practice inspectors of the Provincial Institutes/Ordre, enquiries from members, and suggestions of staff and volunteers working on Standards Group projects. This bulletin does not include information on all projects undertaken during the year by the AASB. It is intended to highlight projects of particular relevance to practitioners. For a complete listing and discussion of projects undertaken, practitioners should refer to the AASB website at www.aasb.ca.

Implementation Support Gateway

The CICA is developing a website to serve as a gateway for information about implementing new accounting, assurance, and public sector standards. Its purpose is to serve as a single source for support materials that will help members learn about, or implement, the standards that affect them. Annotated links will be provided to make it easy to find the information that is most applicable to your particular situation. As the site is new, material will be added on an ongoing basis. The new site is at www.conferences.cica.ca/ssg.

¹ Many practitioners who provide review and compilation services also perform audits of small entities; therefore, some reference to audit material is included in this publication.

Materiality and Review Engagements

Is the practitioner required to calculate materiality when performing a review engagement? This is a question that is often asked of practice advisors of the Provincial Institutes/Ordre.

Neither Section 8100, *General Review Standards*, nor Section 8200, *Public Accountant's Review of Financial Statements*, contains a specific requirement for the public accountant to calculate materiality. However, it is clear from the suggested wording for the public accountant's report on a review engagement that the concept of materiality applies to review engagements. The standard review engagement report states: "Nothing has come to my attention that causes me to believe that these financial statements are not, in all material respects, in accordance with Canadian generally accepted accounting principles" (emphasis added).

There are a number of reasons why it makes sense to calculate materiality for a review engagement. For example, it may assist the practitioner in identifying financial statement items (and underlying account balances) on which to perform review procedures. Further, in performing an analytical procedure, the practitioner develops expectations against which the result of the procedure is compared. A calculated materiality amount can be useful in assessing whether differences between expected amounts and recorded amounts indicate the need for further review, or perhaps an adjustment to the recorded amounts.

It is also worth noting that International Standard on Review Engagements 2400, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* (ISRE 2400), requires the practitioner to apply the same materiality considerations as in audits. While the US standard for review engagements, AR 100, *Compilation and Review of Financial Statements*, does not specifically require the calculation of materiality, it requires the practitioner to obtain sufficient assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.

Practitioners often calculate and apply materiality when performing review engagements. Practitioners who find it useful to calculate and apply materiality on review engagements may wish to consider guidance in Section 5142, *Materiality*, and AuG-41, *Applying the Concept of Materiality*, although review engagements are not specifically within their scope.



Professional Engagement Manual

The Professional Engagement Manual (PEM) underwent a significant update earlier in the summer of 2006. The entire Audit section of the PEM was rewritten to reflect the requirements of the new Audit Risk standards, which were approved by the AASB last summer and are effective for engagements relevant to financial periods beginning on or after January 1, 2006. The Review and Compilation sections of the PEM are currently being revised. Practitioners are advised to refer to the earlier version of the PEM for guidance related to review and compilation engagements.

The PEM is written by Stuart Hartley, FCA, CA•IT, President of FocusROI, a specialized consulting firm, and is published by CICA Member Services. For more information on the PEM, please contact Peter Hoult, CICA Director of Information and Productivity Resources, at peter.hoult@cica.ca or (416) 204-3330.



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 cancelled paper cheques. Cheque imaging involves creating a digital representation of the front and back of the cancelled cheque. Implementation of the initiative is targeted to begin in early 2008, and to be complete nationally 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? Practitioners have traditionally used cancelled paper 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; and
- 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, practitioners 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 the CICA Research Report, “Electronic Audit Evidence,” published in 2003. Although not likely needed for most audits, the practitioner 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 website at www.cdnpay.ca.

New and Proposed Auditing and Assurance Standards and Guidance

Compilation Engagements. The AASB has approved and issued an Exposure Draft to revise Section 9200, *Compilation Engagements*. The proposed revisions are partly in response to concerns raised by practitioners that the wording in the Notice to Reader report does not reflect the level of work performed in certain compilation engagements. The AASB also proposes to remove from the scope of Section 9200 financial information prepared solely for inclusion with corporate, trust and personal income tax filings. Currently there are different practices with respect to communication of association with information included in tax filings. Some practice advisors suggest that the practitioner should include a Notice to Reader on such information even if a compilation engagement has not been performed by the practitioner. Other practice advisors are content with the standard disclaimer included in many tax software packages. The AASB is proposing the change to the scope of the Section in an attempt to achieve some level of consistency of practice. The Exposure Draft has a comment deadline of October 15, 2006.

Management Representations. In the summer of 2005, the AASB approved new Section 5370, *Management Representations*, requiring the practitioner to obtain written representations from management as part of the evidence obtained to support the conclusion in his or her report providing assurance on financial statements. The assurance Recommendations provide basic principles and guidance on the management representations to be obtained.

The AASB also approved revisions to Section 8200, *Public Accountant's Review of Financial Statements*, to provide guidance to a public accountant on obtaining written representations from management as part of the procedures to complete a review engagement. The new Section and the changes to Section 8200

apply to audits and reviews, respectively, of financial statements for periods beginning on or after August 1, 2005.

In the spring of 2006, the AASB approved minor wording changes to the sample management representation letter included as Appendix C to Section 8200. While practitioners are not required to follow the wording in the samples provided in the CICA Handbook – Assurance, those practitioners who have provided the example in Appendix C to clients to use as a template in preparing the management representation letter may wish to provide clients with the updated wording.

Terms of the Engagement. In the summer of 2005, the AASB approved new Section 5110, *Terms of the Engagement*, requiring the practitioner to establish an understanding of the terms of the engagement with an entity and to document this understanding in a written agreement.

The AASB also approved revisions to Section 8200, *Public Accountant's Review of Financial Statements*, to provide guidance to a public accountant on agreeing the terms of the engagement relating to review of an entity's financial statements. The new Section and the changes to Section 8200 apply to audits and reviews, respectively, of financial statements for periods beginning on or after August 1, 2005.

Documentation. Late in 2005, the AASB approved revisions to Section 5145, *Documentation*, requiring the auditor to prepare audit documentation that provides the support for the representations in the auditor's report. Audit documentation should demonstrate that the engagement complied with the Handbook, support the basis for the auditor's conclusions concerning every relevant financial statement assertion, and demonstrate that the underlying accounting records agreed or

reconciled with the financial statements. Section 5145 also requires timely archiving of audit files - within 45 days from the date of issuance of the auditor's report, or if a report is not issued, within 45 days from the date of substantial completion. When the auditor is unable to complete the engagement, this date is 45 days from the date the engagement ceased. Once a file is archived, documents cannot be changed. Additions may be made to the file, but the auditor should document the appropriate reasons for the addition.

In addition to changes to Section 5145, conforming changes were made to GSF-QC, *General Standards of Quality Control for Firms Performing Assurance Engagements*, dealing with access to files and requirements to safeguard confidential client information – both for audit and privacy reasons.

Many practitioners, particularly those who audit small entities, have asked “how much is enough?” While this is to a large extent a matter of professional judgment, guidance is available in the PEM. The PEM contains a number of forms that can assist the practitioner in making decisions on documentation. Practitioners may wish to familiarize themselves with the forms in the PEM. Since the forms are generic and have been developed to apply to a wide range of engagements, practitioners who choose to use the forms should consider amending them as necessary.

The key point to remember regarding documentation is that *if it's not written down, there is no evidence that the work has been done*. Many practitioners will say, “But I know the client – I don't need to write things down.” While this may be true, if something were to happen to the practitioner, critical information may be lost, either temporarily or permanently. Proper documentation ensures the practitioner or others (engagement quality control reviewer, successor auditor, provincial practice inspectors, etc.) will be able to follow the procedures that have been performed to arrive at the final conclusion – the auditor's report.

The revisions apply to audits of financial statements for periods beginning on or after November 1, 2006.

The Auditor's Responsibility to Consider Fraud. Section 5135, *The Auditor's Responsibility to Consider Fraud*, was issued in 2004 and applied to audits of financial statements and other financial information relating to periods ending on or after December 15, 2004. When the Audit Risk standards were updated last year, conforming changes were made to Section 5135 which were effective for audits of financial statements and other financial information relating to periods commencing on or after January 1, 2006. Practitioners are reminded that they should update their procedures related to fraud to take into account the new requirements.

The Auditor's Report. The AASB has approved and issued an Exposure Draft of revisions to Section 5400, *The Auditor's Standard Report*, to adopt the wording of the standard audit report contained in International Standard on Auditing 700 (Revised), *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* (ISA 700). In addition to proposed changes to Section 5400, the AASB proposes to revise sample audit reports on financial statements found throughout the Handbook to conform with the proposed wording in the Exposure Draft. The Exposure Draft has a comment deadline of September 30, 2006.

A second phase of this project will address the remaining issues in ISA 700 and proposes to adopt ISA 700, along with International Standards on Auditing 701, *The Independent Auditor's Report on Other Historical Financial Information*, and 800, *The Auditor's Report on Special Purpose Audit Engagements*. Various other Sections may be impacted by this project.

Going Concern. In June 2006, the AASB approved an Exposure Draft of a new Section, *Going Concern*, dealing with the auditor's responsibility to assess whether there are material uncertainties related to events or conditions that may cast substantial doubt on the audited entity's ability to continue as a going concern for a period of twelve months from the date of the financial statements when auditing financial statements that have been prepared on the going concern basis. The Exposure Draft has a comment deadline of October 31, 2006.

Audit of a Small Entity. The CICA Audit Technique Study, "Audit of a Small Business," was updated in the spring of 2006 to reflect changes in assurance standards. This Study was last updated in 1994. This third edition discusses how to conduct an effective and efficient audit of a small entity in the context of current practice and standards.

The Study:

- discusses the characteristics of a small entity and an audit of a small entity;
- considers how new and proposed standards on audit risk, quality control, internal control and fraud considerations

- will apply to the audit of a small business;
- addresses the impact of the new independence rules on the auditor of a small business;
- discusses common audit problems and auditor-client relationships in a small business audit context; and
- provides practical guidance on auditing a small entity in the 21st century.

For further information on these and other projects, and for copies of documents for comment, refer to the AASB website at www.aasb.ca.

New and Revised Assurance Handbook Sections and Guidelines. The following Sections and Guidelines have been issued since the last issue of *Practice Advice* (September 2005):

| Section | Name | Effective date |
|---------|--|--|
| 5021 | <i>Authority of Auditing and Assurance Standards and Other Guidance</i> | Applies to financial statements and financial reports for periods commencing on or after September 1, 2005 |
| 5145 | <i>Documentation</i> | Applies to audits of financial statements for periods commencing on or after November 1, 2006 |
| 5150 | <i>Planning</i> | Applies to audits of financial statements for periods commencing on or after January 1, 2006 |
| 5310 | <i>Audit Evidence Considerations When an Entity Uses a Service Organization</i> | Applies to financial statements and financial reports for periods beginning on or after January 1, 2006 |
| AuG-42 | <i>Service Organizations that Use Other Service Organizations</i> | Applies to engagements covering periods commencing on or after January 1, 2006 |
| AuG-43 | <i>Audit of Policy Liabilities of Insurance Companies</i> | Applies to audits of financial statements relating to years commencing on or after January 1, 2006 |
| AuG-44 | <i>The Auditor's Consent to the Use of the Audit Report in a Continuous Disclosure Document</i> | Applies to reports issued on or after December 1, 2005 |
| AuG-45 | <i>Legislative Auditor's Report on Financial Statements of a Federal, Provincial or Territorial Government</i> | Applies to audit reports issued on or after July 1, 2006 |

The following Section and Guideline have been withdrawn since the last issue of *Practice Advice* (September 2005):

| Section | Name |
|---------|---|
| 5610 | <i>Foreign Reporting</i> |
| AuG-15 | <i>Audit of Actuarial Liabilities of Life Insurance Enterprises</i> |

For more information on these and other projects of the AASB, including standards issued in the past year, refer to www.aasb.ca.

Accounting Standards Board: Activities

The Accounting Standards Board (AcSB) has focused much of its attention in the past year on the development of its new Strategic Plan (see more below). Since the approval and issuance of its suite of Financial Instruments standards, there has been a significant reduction in the number of standards issued by the AcSB. The AcSB has recently issued an Exposure Draft, "Inventories," that may be of interest to small practitioners. The Exposure Draft and background material can be found on the AcSB's website at www.acsbcanada.org. It has a comment deadline of September 15, 2006.

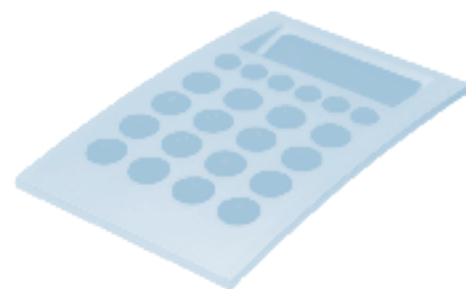
New and Revised CICA Handbook – Accounting Sections and Guidelines. The following Sections and Guidelines have been issued since the last issue of *Practice Advice* (September 2005):

| Section | Name | Effective date |
|---------|--|---|
| 1506 | <i>Accounting Changes</i> | Applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007 |
| 3831 | <i>Non-Monetary Transactions</i> | Effective for non-monetary transactions initiated in periods beginning on or after January 1, 2006 |
| Various | Section 1530, <i>Comprehensive Income</i> ; Section 1651, <i>Foreign Currency Translation</i> ; Section 3051, <i>Investments</i> ; Section 3251, <i>Equity</i> ; Section 3855, <i>Financial Instruments – Recognition and Measurement</i> ; Section 3861, <i>Financial Instruments – Disclosure and Presentation</i> ; Section 3865, <i>Hedges</i> ; and amendments to Section 3025, <i>Impaired Loans</i> | Effective dates for non-publicly accountable enterprises have been deferred to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. This deferral does not apply to not-for-profit organizations |

For more information on these and other projects of the AcSB, including standards issued in the past year, refer to www.acsbcanada.org.

Accounting Standards Board: New Direction

In the last issue of *Practice Advice* (September 2005), we reported that the AcSB was in the process of developing a new Strategic Plan. This new Plan was approved by the AcSB in early 2006. A key area of interest for readers of this publication is reporting models for non-publicly accountable enterprises. The AcSB is currently conducting research into this area. Further details of the AcSB's new strategic direction can be found at www.acsbcanada.org/planning.



Auditing and Assurance Standards Board: Future Directions — Draft Strategic Plan

In June 2006, the AASB approved its new strategic direction. The AASB's standard-setting program will focus on converging Canadian auditing and assurance standards with the International Standards on Auditing (ISAs). This decision took into account responses to the AASB's Invitation to Comment, "Auditing and Assurance Standards in Canada — Maintaining high standards in a global environment," which was issued in November 2005. In their responses, the vast majority of stakeholders expressed strong support for the AASB's proposal to converge with the ISAs.

Written comments received, along with the Invitation to Comment, can be accessed at www.aasb.ca/planning.

Practice Inspection Issues

Practice Inspection departments of the Provincial Institutes/Ordre have reported that although the results of inspections conducted during the 2005-06 year were generally favourable, deficiencies are still being found in the conduct of audits and reviews.

Areas of concern identified during inspection of review engagement files include failure to appropriately document:

- enquiry, analytical procedures and discussion of:
 - inter-relationship/comparison of revenues, expenses, gross margin, operating ratios and balance sheet items;
 - cut-off procedures related to cash, sales, purchases, inventory and accounts payable;
 - client's inventory count procedures and valuation of inventory; and
 - plausibility of GST and PST balances; and
- assessment of independence and client retention/acceptance.

Deficiencies were also identified with respect to financial statement presentation, including disclosure of:

- financial instruments — nature and extent, credit risk, interest rate risk and fair value;
- cash flow statements — interest and income taxes paid;
- authorized share capital;
- security for short-term bank indebtedness;
- related party transactions — terms and conditions for amounts due to/from related parties and the measurement basis; and
- revenue recognition policy.

Guidance and direction regarding review engagement procedures can be found in Assurance and Related Services Guideline AuG-20, *Performance of a Review of Financial Statements in Accordance with Sections 8100 and 8200*. Further guidance is available to practitioners in the PEM. For more information regarding assessment of independence and client retention/acceptance, practitioners should refer to the Rules of Professional Conduct of their respective Provincial Institute/Ordre. Recommendations and guidance related to client retention/acceptance can also be found in GSF-QC, *General Standards of Quality Control for Firms Performing Assurance Engagements*, and Section 5030, *Quality Control Procedures for Assurance Engagements*. Further guidance on the Quality Control standards can be found in the CICA Quality Assurance Manual.

Reference Tools for Practitioners

In addition to this newsletter, a number of other newsletters and sources of information are available to practitioners. The following is a list of some publications the practitioner may find useful (however, this list is not intended to be all-inclusive):

| | |
|-----------------------|--|
| AASB Update | A newsletter on the activities of the AASB and staff |
| FYI | Highlights of activities of the Accounting Standards Board and staff |
| Risk Alert | Bulletin highlighting specific topics of interest for chartered accountants performing audits and reviews |
| CA Practice Advantage | A complimentary quarterly e-newsletter for CAs in public practice providing timely synopses of information with links to the web-based sources |

Practitioners will also find useful information on activities of the AASB and the AcSB at their websites (www.aasb.ca and www.acsbcanda.org, respectively), including detailed information about project activities, copies of exposure drafts, effective dates for new standards, updated information about international activities and other reference material. Practitioners may wish to bookmark the AASB home page.

A wealth of information is also available on the websites of the various Provincial Institutes/Ordre of Chartered Accountants. Specific questions may be directed to PICA/Ordre Practice Advisors. Links to the various websites can be found on the CICA website (www.cica.ca) under "About the Profession".

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COMMENTS

Practice Advice welcomes all comments, letters and suggestions for future issues. Please send them to:

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