

Focus on Practice Review – 2021

December 2021

CPA Alberta's Practice Review program plays an essential role in protecting the public by assessing firms' compliance with professional standards and taking appropriate follow-up action or remedial action in instances of non-compliance. Professional standards assessed against include those in the CPA Canada Handbooks, the CPA Alberta Rules of Professional Conduct and the Tax Management Standards approved by the CPA Alberta Board. It is important to note that Practice Review does not set standards.

CPA Alberta's Practice Review program also plays a role in protecting the public by providing one-on-one interaction and education to firms in the practice review process.

UNDERSTANDING PRACTICE REVIEW

Practice reviews of firms are undertaken not less than once every three (3) years, providing that a firm complies with the practice review cycle. If a practice review does not result in a comply assessment, a follow-up practice review is done within one year from the initial review. The practice review cycle is also adjusted by considering risk indicators, including date of registration with CPA Alberta and the Canadian Public Accountability Board ("CPAB"), significant changes in scope of practice, type of clients or composition of registrant, failure to meet professional development requirements, previous practice review results, disciplinary information, and any other information warranting an increased rate of practice review.

Over the past 21 months, the majority of practice reviews were performed remotely. During the remote practice review process, each firm provided the files selected for review to their practice reviewer(s) through a secure file transfer site. Discussions of practice review findings and educational comments were held through telephone or video conferencing, depending on firm preference.

For those firms which were unable to provide electronic working paper files, practice reviews were performed as paper file reviews by CPA Alberta staff in either the CPA Alberta Edmonton or Calgary offices. Discussions of practice review findings and educational comments were held through telephone or video conferencing, depending on firm preference.

Prior to being assessed by the Practice Review Committee (the "Committee"), a copy of the draft practice review report is sent to each firm, which then has the opportunity to respond to the deficiencies identified. In its assessment on compliance, the Committee considers both the draft practice review report prepared by the practice reviewer and the firm response.

While the Committee considers all deficiencies in its assessment and expects all deficiencies to be corrected, certain deficiencies are more concerning to the Committee. For these deficiencies, firms are required to provide their remedial action in their responses. These types of deficiencies are the focus of this report.

PRACTICE REVIEW COMMITTEE

The Practice Review Committee is comprised of twelve (12) CPA members and one (1) public member who does not hold the CPA designation. Committee members are appointed by the CPA Alberta Board.

Geographic location and practice size are considered in determining Committee membership. As well, the Committee collectively possesses experience with and technical knowledge of a broad range of sectors, including accounting and auditing relating to reporting issuers, local governments, not-for-profit organizations, pension plans, and private enterprises. Their knowledge and experience also includes both assurance and compilation engagements.

The Committee holds seven (7) meetings annually and considers approximately 75-90 practice reviews at each meeting. The Committee assesses practice review reports and any comments received from firms on an anonymous basis.

Factors considered by the Committee in determining the action(s) to be taken following a practice review may include but are not limited to:

- The nature and severity of identified deficiencies;
- The number of identified deficiencies;
- The firm's response to identified deficiencies, including those requiring remedial action;
- The firm's quality control systems and whether monitoring was performed;
- The cooperation of the firm;
- The public interest; and
- In a follow-up practice review, the results of the initial review and the degree to which the firm addressed identified deficiencies.

The Committee may determine to do one or more of the following:

- Direct a follow-up practice review;
- Direct the establishment and implementation of a professional development plan, or a plan to maintain and improve professional standards;
- Direct that courses, examinations, tutorial or other forms of professional development or skills training be taken;
- Recommend practice improvement, practical experience or the engagement of a mentor;
- Make a complaint to CPA Alberta's Complaints Inquiry Committee (the "CIC").

If the Committee concludes its directed remedial action has not been effective and other consequences are required to protect the public, the Committee will then refer the matter to the CIC. Matters referred to the CIC by the Committee include:

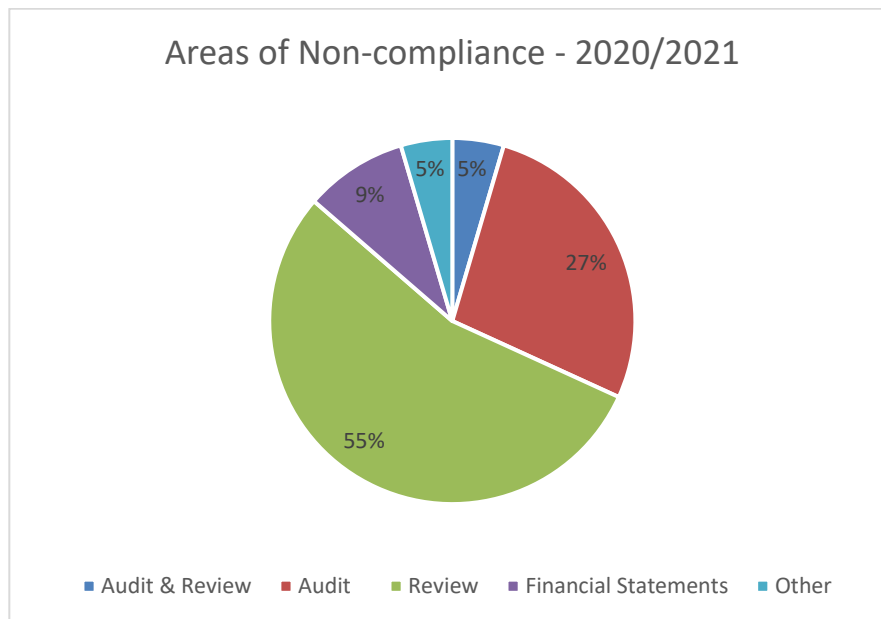
- Not cooperating with the practice review process;
- Continuing lack of success adhering to professional standards;
- Choosing not to take the professional development directed by the Committee;
- Performing engagements the firm is not registered to perform; and
- Breaching the CPA Alberta Rules of Professional Conduct.

After each Committee meeting, the Committee's decisions and the final practice review report are communicated in writing to each firm.

PRACTICE REVIEW OBSERVATIONS

This past year, 451 practice reviews were completed, of which 44 required a follow-up practice review. The Committee directed attendance to 68 professional development courses and made three (3) complaints to the CIC.

Of the 44 practice reviews requiring a follow-up practice review, the following graph depicts the areas of non-compliance.



Clearly, the highest area of non-compliance over the last year was review engagements at 60%, followed by audit engagements at 32%. Note that the “Financial Statements” category is for non-compliance in generally accepted accounting principles such as IFRS, ASPE, NFPO, Pension Plan or Public Sector and non-compliance in the “Other” category is primarily compilation engagements.

In this report, the results of practice reviews and observations and suggestions for improvement are highlighted to assist practitioners in performing high-quality engagements. Following are critical deficiencies identified during the practice review process. Given the seriousness of these deficiencies, the Committee requires firms’ remedial action plans when making assessments on compliance. If the firm’s remedial action plan is not satisfactory to the Committee, it may consider the firm a serious risk to the public, resulting in an assessment of non-compliance with professional standards and related consequences.

1. REVIEW ENGAGEMENTS

The largest area of non-compliance continues to be in the area of review engagements. This is likely the result of a new review engagement standard, CSRE 2400, which was mandatory for reviews of financial statements for periods ending on or after December 14, 2017. While it is now more than three years since the mandatory effective date, continuing high levels of non-compliance are not surprising. This is because it is still within the first practice review cycle after the required implementation of the new CSRE 2400 standard and if the old standard is applied instead of the CSRE 2400 standard, the Committee determines the firm to not be in compliance with professional standards.

During the past year the Committee assessed many firms as not complying in the area of review engagements as a result of new requirements in CSRE 2400; however, the Committee also assessed a number of firms as not complying in the area of review engagements as a result of performing insufficient review engagement procedures. This was also required under the old standard.

Specific areas within CSRE 2400 where deficiencies were most frequently observed are described below.

1.1 UNDERSTANDING THE ACCOUNTING SYSTEMS AND ACCOUNTING RECORDS

The client's accounting systems and records form the basis of the financial statements and provide information relied upon during the review engagement. Therefore, understanding the accounting systems and records used by an entity is vital to performing a review engagement. This helps to identify areas where a material misstatement is likely to arise and the procedures to be performed, allowing the practitioner to focus analysis and inquiry on the right areas. Practitioners should document accounting systems and records in sufficient detail to enable an experienced practitioner having no previous connection with the engagement to understand the systems and records. For example, brief and superficial documentation of accounting systems and records does not result in a meaningful analysis.

Deficiencies of no or inadequate understanding of the accounting systems and accounting records are concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CSRE 2400.43-.44]

1.2 AREAS WHERE MATERIAL MISSTATEMENTS ARE LIKELY TO ARISE

A critical element of CSRE 2400 is the identification of areas where material misstatements are likely to arise. If this assessment is not completed and documented, it is possible that appropriate inquiries and analytical procedures may not be designed and performed.

Inquiry and analytical procedures are required for all material items in the financial statements, including disclosures. When a practitioner has identified an area where material misstatement is likely to arise, additional procedures should be performed to focus on addressing the area. For example, a transaction or event outside of the normal course of business or a subsequent event may be considered an area where material misstatement is likely to arise, requiring focused procedures. These areas may not necessarily be material items in the financial statements.

Areas where material misstatements are likely to arise can be identified in all entities; it is therefore not sufficient to document “there are none”. Deficiencies for not identifying areas where material misstatements are likely to arise are concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm’s response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CSRE 2400.45-.46]

1.3 INQUIRIES OF MANAGEMENT AND OTHERS WITHIN THE ENTITY

Evidence obtained through inquiry is often the principal source of understanding concerning the entity’s activities, management’s actions during the year, and their plans. CSRE 2400 includes an extensive list of required inquiries of management and others within the entity.

Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matters that would cause the practitioner to believe the financial statements may be materially misstated. This analysis should not be performed as a perfunctory exercise. For example, one-word responses are not sufficient for inquiries that clearly require a more detailed response.

Inquiries regarding going concern and the existence of any actual, suspected, or alleged fraud or illegal acts and non-compliance with provisions of laws and regulations are particularly important. Management’s responses to these inquiries may result in disclosure in the financial statements or changes to the measurement of amounts in the financial statements. The practitioner may also be required to perform additional procedures and communicate the matter with the appropriate level of senior management or those charged with governance.

Related party transactions are sensitive and important for users of the financial statements to understand. Therefore, inquiry regarding the identification of related parties and related party transactions, including the purpose of those transactions, is critical. It is also important the practitioner remain alert throughout the engagement for related party transactions that management may not have identified or disclosed to the practitioner.

Documentation of inquiries should include when the discussions took place and with whom. It is not sufficient to simply document “none”. Deficiencies for not documenting a significant number of the required inquiries are concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm’s response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CSRE 2400.47, .49-.53]

1.4 REVIEW ENGAGEMENT PROCEDURES

In order to obtain sufficient appropriate evidence as the basis for conclusion on the financial statements as a whole, inquiry and analytical procedures must be performed to address both the areas where material misstatement are likely to arise and all material items in the financial statements, including disclosures. If sufficient appropriate procedures are not performed and documented, the conclusion and report issued may be incorrect. For many of those firms the Committee determined not to be in compliance with professional standards, sufficient appropriate evidence was not obtained on one or more material items in the financial statements.

Lack of documentation of sufficient appropriate evidence is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CSRE 2400.46]

2. AUDIT ENGAGEMENTS

The second largest area of non-compliance continues to be in audit engagements. Specific areas where deficiencies were most frequently observed are described below.

2.1 AUDITING REVENUE

Revenue is an area that often has unique risks and a greater susceptibility to material misstatement. Risks may arise both from complex recognition requirements related to the characteristics of revenue streams and the presumptive risk of fraud. In all but the simplest environments, revenue recognition should generally be considered a significant risk in the audit and substantive procedures and/or control testing performed to mitigate the risk.

Practice Review identified instances in which practitioners did not plan and perform appropriate audit procedures to respond to these risks. For example, audit teams may not have adequately evaluated all material types of revenue. As a result, procedures were not performed to address the risks related to each significant revenue stream.

Lack of documentation of sufficient appropriate evidence when auditing revenue is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CAS 240 and 330]

2.2 AUDITING EXPENSES

Practice Review frequently identifies deficiencies relating to the nature and extent of substantive procedures performed with respect to expenses. Substantive procedures can consist of substantive analytical procedures or tests of details. When performing tests of details, auditors must ensure their procedures address the risks identified by assertion. For example, when testing for completeness expenses should be traced from source documents to the general ledger, while to test cut-off a review of expense transactions around year-end should be performed.

Lack of documentation of sufficient appropriate evidence when auditing expenses is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CAS 330]

2.3 SUBSTANTIVE ANALYTICS

Substantive analytical procedures are often used on their own or in conjunction with other substantive procedures to provide evidence to support the audit opinion. In general, substantive analytical procedures are most effective when evaluating large volumes of transactions in a highly-predictable environment.

In determining which audit procedures to design to address audit risks, practitioners should carefully consider the suitability of using substantive analytical procedures. The suitability of an analytical procedure will depend upon the practitioner's assessment of how effective the procedure will be in detecting a misstatement that may cause the financial statements to be materially misstated. The performance of simple year-over-year analytics generally does not meet the criteria of a substantive analytical procedure. Effective substantive analytical procedures require the development of expectations using reliable and accurate information, the determination of appropriate thresholds for further investigation, and the follow-up of outliers through discussion with management and by obtaining corroborating evidence.

When using substantive analytical procedures for audit evidence, documentation should clearly identify how the expectation is calculated, the threshold for further investigation, the explanation for any deviations from threshold, and the conclusions reached.

Lack of documentation of substantive analytics is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CAS 520]

2.4 AUDIT SAMPLING

When conducting substantive procedures, an auditor commonly tests less than 100 per cent of a balance or transaction stream. Instead, they will test a sample. When selecting a sample, practitioners should:

- Select a representative sample;
- Perform appropriate audit procedures; and
- Evaluate results to obtain reliable, relevant, and sufficient appropriate evidence to form a conclusion on the population as a whole.

It is critical that the sample represents the population. For example, a practitioner may employ a standard sample size without regard to the nature of the population and the objectives of the procedure. Practitioners must ensure that all items in a population have an equal chance of being selected. Where populations can be disaggregated, for example in situations where there are multiple revenue streams, each distinct sub-population should be sampled independently.

When using audit sampling in an engagement, documentation should allow an experienced practitioner to replicate the test and reach the same conclusions. To meet the re-performance expectation, documentation should indicate the population being tested, how the sample size was determined, how the sample was selected, extrapolation of any errors, and the conclusions reached.

Insufficient or inappropriate audit sampling is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CAS 530]

2.5 AUDITOR'S REPORT

The auditor's report is the firm's communication to users of the audited financial statements. Over the last year, Practice Review has seen a number of auditor's reports that were not in accordance with CPA Canada Handbook – Assurance, post auditor reporting, CAS 700. Rather the reports were issued in the format required for the audit of financial statements for a period ending before December 15, 2018.

In the majority of these practice reviews, Practice Review has also seen appropriately issued auditor's reports on other audit engagements. Therefore, practitioners are reminded to carefully review each auditor's report before issuing to ensure the requirements are met.

Using the old auditor's report is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action. The firm's response is important to the Committee in making its assessment. In its response, the firm is encouraged to consider not only the actions to be taken on a go forward basis, but also the actions to be taken on the current engagement.

[CPA Canada Handbook – Assurance; CAS 700]

3. COMPILATION ENGAGEMENTS

Over the past year there were 205 practice reviews performed on offices performing only non-assurance engagements such as compilation and specified auditing procedures engagements. The majority of these firms were assessed as being in compliance with the old compilation engagement standards.

The new compilation engagement standard, CSRS 4200, was issued in February 2020 and is effective for compiled financial information for periods ending on or after December 14, 2021, with early adoption being permitted.

Practice Review has seen very few firms early adopting this new standard. The handful of engagements Practice Review reviewed under CSRS 4200 were generally poorly performed and did not meet the minimum standards.

In the majority of these engagements not meeting the minimum standards, the new compilation engagement report was included along with a basis of accounting note to the financial information. However, the other requirements of CSRS 4200 were not considered.

In one of the instances, the basis of accounting note also inappropriately disclosed the financial statements were prepared in accordance with accounting standards for private enterprises when they were not.

3.1 IMPORTANT CONSIDERATIONS WHEN APPLYING CSRS 4200

Practitioners should read the CSRS 4200 in its entirety to understand the complete impact of the new requirements. Several of the important considerations are discussed here.

Prior to accepting or continuing a compilation engagement, the practitioner is required to make inquiries of management regarding the intended use of the compiled financial information, including whether that information is intended to be used by a third party. The practitioner is also required to obtain an acknowledgement from management of the basis of accounting expected to be applied in the preparation of the compiled financial information.

When the financial information is intended to be used by a third party, the practitioner may only accept or continue the engagement if the third party is:

- a) In a position to request and obtain further information from the entity; or
- b) Has agreed with management the basis of accounting to be applied in the preparation of the compiled financial information.

If neither of these are met, the practitioner shall not accept or continue the engagement, unless the basis of accounting to be applied in the preparation of the compiled financial information is a general purpose framework. It is expected that compiled financial information prepared in accordance with a general-purpose framework such as ASPE will be rare.

In order to demonstrate compliance with CSRS 4200, these items must be documented in the file prior to the completion of the compilation engagement.

[CPA Canada Handbook – Assurance; CSRS 4200.22-.23]

Another important consideration that differs from the old compilation engagement standard is the practitioner is now required to understand the entity’s business operations, the entity’s accounting system and records, and the basis of accounting to be applied. This understanding must be documented sufficiently for an experienced practitioner, having no previous connection with the engagement, to understand how the requirements were met.

[CPA Canada Handbook – Assurance; CSRS 4200.27, .39]

It is also important to ensure the new compilation engagement report is used on the compiled financial information and the compiled information includes a note that accurately describes the basis of accounting applied.

[CPA Canada Handbook – Assurance; CSRS 4200.28, .37]

The practitioner shall obtain an acknowledgment from management or those charged with governance, as appropriate, that it has taken responsibility for the final version of the compiled financial information. The practitioner is required to obtain this acknowledgment prior to dating the compilation engagement report. Examples of management’s acknowledgement may be a signed copy of the final version of the compiled information, a written communication, or an oral acknowledgement that is documented by the practitioner.

[CPA Canada Handbook – Assurance; CSRS 4200.33, .38]

The appendix to this article includes links to useful resources when implementing CSRS 4200.

3.2 QUALITY MANAGEMENT STANDARDS FOR COMPILATION ENGAGEMENTS – NEW

Quality management standards for other related services, such as compilation engagements, were introduced into the CPA Canada Handbook – Assurance earlier this year in May 2021. Firms performing only compilation engagements are now required to design and implement systems of quality management by December 15, 2023. This is discussed further in this report under 4.3 CANADIAN STANDARDS ON QUALITY MANAGEMENT – NEW.

4. QUALITY CONTROL

A well-thought-out and well-executed quality control system is required. If it is designed and implemented effectively, overall quality improves and deficiencies decrease.

4.1 MONITORING

One of the most effective components of quality control is the completion of monitoring, which is vital to ensure firms identify and correct any breakdown in quality controls in a timely manner. Practitioners should assess overall quality control annually and review completed assurance engagements on a cyclical basis. Monitoring should be performed in sufficient depth and by appropriate individuals. The absence of effective monitoring greatly impacts quality and is often a significant factor in whether firms comply with the practice review cycle.

Cyclical monitoring of completed assurance engagements is required to be completed by someone not involved in the engagement. A common challenge for sole practitioners or smaller partnerships is the lack of independence within the practice to perform cyclical monitoring activities. In these instances, practitioners may fulfil their cyclical monitoring obligations by engaging an external monitoring service provider. Firms searching for a cyclical monitoring service provider can contact CPA Alberta for a list of firms offering these services.

To have a positive effect on quality, it is essential that monitoring results are shared within the practice and that any corrective action is planned and executed in a timely manner. To achieve the benefits of monitoring, it is not enough to simply record the results—it is critical to develop and execute a plan of action.

The absence of cyclical monitoring is concerning to the Committee, and the firm will be asked to respond to the Committee on its remedial action.

[CPA Canada Handbook – Assurance; CSQC 1.48-.54]

4.2 ENGAGEMENT QUALITY CONTROL REVIEW

A firm's Quality Manual establishes its policies and procedures on engagement quality control review ("EQCR"). An EQCR is not the same as cyclical monitoring. Cyclical monitoring is designed to provide reasonable assurance that policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. An EQCR is part of completing the audit or review engagement and must be completed before the engagement report is dated.

In order to demonstrate compliance with the firm's Quality Manual, a firm must complete an EQCR when the criteria it established are met.

[CPA Canada Handbook – Assurance; CSQC 1.35-.42]

4.3 CANADIAN STANDARDS ON QUALITY MANAGEMENT – NEW

In May 2021, Canadian Standard on Quality Management 1 (“CSQM 1”), Engagement Quality Control Reviews (“CSQM 2”), Quality Management for an Audit of Financial Statements (“CAS 220”), and related conforming amendments to other CASs were included in the CPA Canada Handbook – Assurance. CSQM 1 and CSQM 2 replace the Canadian Standard on Quality Control 1 (“CSQC 1”).

Under CSQM 1, firms are required to design and implement their system of quality management for audits or reviews of financial statements or other assurance engagements by December 15, 2022. Firms are then required to evaluate their quality management system within one year from this date.

Under CSQM 1, firms are required to design and implement their system of quality management for related services engagements by December 15, 2023. Firms are then required to evaluate their quality management system within one year from this date. Firms performing compilation and agreed-upon procedures engagements are considered related services engagements. This is a significant change for firms performing only other related services engagements as they have never before had a quality management requirement.

These standards have significant changes from the previous CSQC 1, and practitioners are encouraged to closely examine these standards well in advance of the effective dates to ensure they are appropriately implemented.

The appendix to this article includes a link to CPA Canada’s website and the New Quality Management Suite of Standards: Practitioner Alert.

QUESTIONS

Should you have questions and/or require more information on any of the above, please contact Erin Wallish, CPA, CA, Director of Practice Review, at ewallish@cpaalberta.ca. General questions on other issues related to professional services should be directed to Randy Nicholls, CPA, CA, Director, Member Engagement, at rnicholls@cpaalberta.ca.

APPENDIX – RESOURCES

In addition to the CPA Canada Handbooks on Accounting and Assurance (which can be found at Knotia.ca, www.knotia.ca, and are free for all CPA Canada members), there are many other resources available at no charge to Alberta CPAs.

COMPILATION ENGAGEMENT RESOURCES

The CPA Canada website has various compilation engagement resources at <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/blog/2021/march/new-standard-on-compilation-engagements>

NEW QUALITY MANAGEMENT SUITE OF STANDARDS: PRACTITIONER ALERT

The CPA Canada website has a practitioner's alert on the new CSQM 1, CSQM 2 and CAS 220 at <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/standards-other-than-cas/publications/new-quality-management-standards-practitioner-alert>

AUDIT AND ASSURANCE RESOURCES

The CPA Canada website has various audit and assurance resources at <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance>.

The Financial Reporting & Assurance Standards Canada website (www.frascanada.ca) contains useful guidance on all the Canadian accounting frameworks and assurance standards, along with information on developing issues and discussions on proposed new standards.

COVID-19 RESOURCES

To assist CPAs in addressing challenges arising from COVID-19, CPA Alberta and CPA Canada have a number of resources and services available. Please see:

- <https://www.cpaalberta.ca/Services/Online-Resource-Centre/COVID-19-Online-Resources>
- <https://www.cpacanada.ca/en/members-area/covid-19-resources>

The Canadian Public Accountability Board (CPAB) also has various resources available at <https://cpab-ccrc.ca/insights/covid-19>.