ORDRE DES COMPTABLES PROFESSIONNELS AGRÉÉS DU QUÉBEC

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2019–2020

Professional inspection review

Highlights and analysis

About the Professional inspection committee

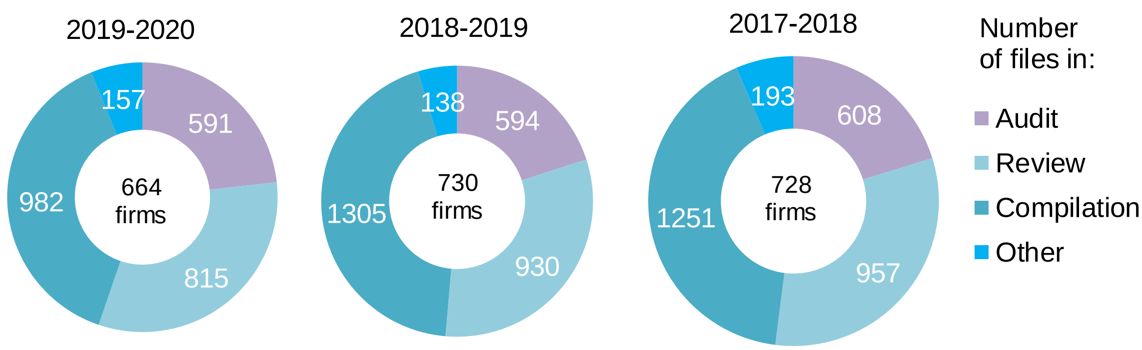
The primary mission of the Professional inspection committee is to protect the public while ensuring Quebec CPAs meet the highest standards of quality. Every visit is an opportunity to guide members in their pursuit of excellence by helping them better comply with the standards of the profession as well as perfect their work methods.

The Professional inspection committee (the Committee) has therefore prepared an annual report on the inspection results, including:

- ✓ Highlights of 2019–2020 inspection results
- ✓ Analysis of areas for improvement
- ✓ Practical advice
- ✓ Tools to assist you in your commitment to excellence

Scope of 2019–2020 inspections

During the 2019–2020 inspection period, 664 firms were inspected compared with 730 firms in the previous period.[1] This number varies from year to year depending on the inspection cycle and the client portfolios of firms inspected.



Selection of files inspected

File selection is focused on those files representing a greater risk in terms of public protection and quality of work. This allows for a more in-depth inspection of more complex transactions, on subjects deemed likely to pose difficulties in practice or on areas of activity requiring the practitioner's particular knowledge.

All files completed during the same inspection cycle are subject to inspection. Therefore, any files completed within the last three or four years can be selected.

[1] The population referred to in this table includes all practising units inspected during the fiscal year. The number of units for which the decision was ratified in 2019–2020 is 632 (687 in 2018–2019).

Overview of inspection results

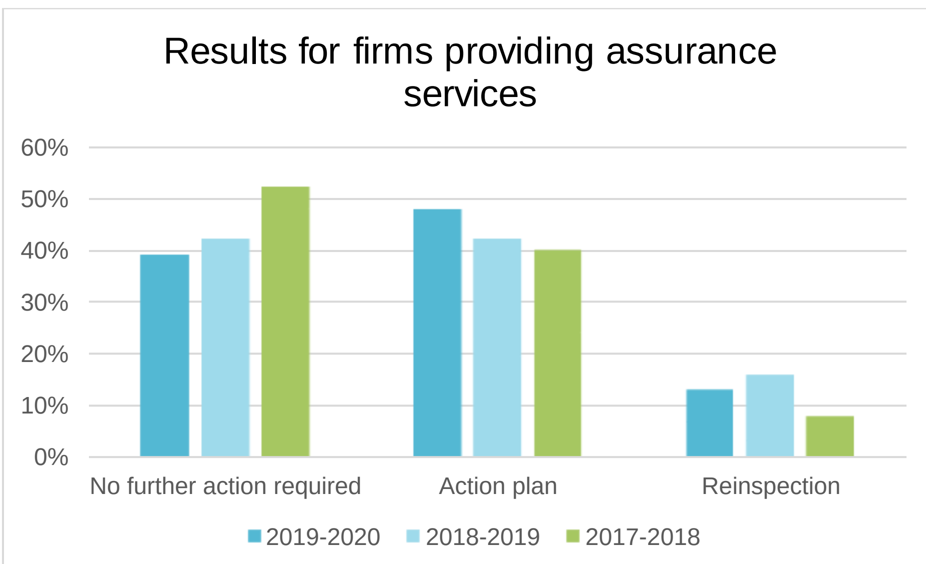
92 % percent of the firms inspected met the requirements of the professional inspection program compared to 91 % in the prior year.

Below is the rate of compliance with the inspection program requirements by type of firm:

- 99% (98% in 2018–2019) for the 252 firms (239 in 2018–2019) offering only compilation or other services; and
- 87% (84% in 2018–2019) for the 412 firms (491 in 2018–2019) offering assurance services.

Among firms providing assurance services:

- 39% fully met the requirements (42% in 2018–2019);
- 48% required an action plan (42% in 2018–2019); and
- 13% did not meet the requirements (16% in 2018–2019).



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Overview of areas for improvement

Several findings recur across multiple inspection years. In this overview, the Committee presents the deficiencies that most impacted quality of work and that generally led to the conclusion that an inspected firm did not meet the requirements or required an action plan. The Committee will continue to work with its collaborators, especially the Continuing Education team, to determine how to assist members in addressing deficiencies identified.

Financial accounting

The Committee is especially sensitive to accounting and financial reporting issues since a significant deficiency can result in issuing false or misleading financial statements. The Committee asks that practitioners be particularly vigilant in the presence of the following items.

Complex or non-recurring transactions

In this respect, the major challenges facing members are:

- issue identification and assessing the appropriate accounting treatment;
- designing appropriate procedures to obtain a sufficient level of assurance based on the type of engagement and the level of risk; and
- a lack of expertise or consultation of available resources (for example - Quebec CPA Order's technical reference service, CPA colleagues, other experts).

Revenue recognition

Often, the terms and conditions of agreements with clients are not well documented. As a result, the accounting policies for revenue recognition are not sufficiently analyzed thereby increasing the risk of error, particularly in situations where revenue recognition does not match delivery or payment. The practitioner should ensure that sufficient information is gathered about contracts with clients to be able to determine the terms and conditions that could affect the amount or timing of revenue recognition. The understanding of sales contracts should include, but not be limited to, the following:

- the nature of client deliverables;
- the consideration exchanged (including rebates and discounts);
- the transfer of ownership (including rights of acceptance and return); and
- the delivery terms.

Where these elements are more complex, consultation with a subject matter expert should be considered.

Recognition of intangible assets

Deficiencies related to the recognition of intangible assets are frequently identified. The most common situations where the recognition criteria had not been properly identified or analyzed, include the following:

- client relationships/lists and other intangible assets were not recognized when allocating the purchase price in a business acquisition;
- internally generated brand names and client lists were inappropriately recognized as intangible assets when this accounting treatment is not permitted by the applicable standards; and
- development expenditures that had not met the recognition criteria were recognized as intangible assets.

The practitioner must ensure that any asset recognized meets the recognition requirements of the applicable standard. Assurance procedures should therefore be designed to address recognition criteria.

Assessment of the entity’s ability to continue as a going concern

Deficiencies are frequently observed when financial statements are prepared on a going concern basis despite the existence of events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern. These include:

- non-disclosure of these uncertainties in the notes to the financial statements and in the practitioner’s report; and
- a lack of documentation of the evidence that led the practitioner to conclude that such disclosure is not required.

To address these deficiencies, practitioners should:

- better document the assessment of events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern;
- document procedures implemented to assess management’s plan of action and the feasibility of these; and
- reach a conclusion as to whether the financial statements are materially misstated due to inadequate disclosure about a material uncertainty related to the entity’s ability to continue as a going concern.

Review engagements

Application of CSRE 2400 – Review engagements

60% of inspections not meeting program requirements were the result of deficiencies identified in review engagements.

For many firms inspected in 2019–2020, this was the first professional inspection since the Canadian Standard on Review Engagements (CSRE 2400) came into effect. Although most firms applied it appropriately, for some this standard remains a significant challenge. In certain cases, members had not modified their procedures to address the implications of the standard. In other cases, the nature and scope of documentation required was insufficient to meet the requirements of the standard.

The main findings specific to review engagements can be grouped into two broad categories:

Understanding of the entity and its environment

Obtaining and documenting an understanding of the entity and its environment is a key step in a review engagement conducted under CSRE 2400. This understanding should be sufficiently detailed to enable the practitioner to adequately assess the areas where material misstatements are likely to arise and to design appropriate procedures. A lack of planning will have a direct impact on the quality of the engagement, and therefore on the results of the inspection.

REMINDER

- Information requests and analytical procedures are required for all significant areas of the financial statements, including complex transactions and disclosures.
- When an area where a material misstatement is likely to arise is identified, additional procedures must be performed for that area.

For firms that have not met the requirements of the inspection program, the documentation of the entity's understanding is often limited to a few words and does not refer to the terms and conditions of contracts with customers, suppliers, and other parties, which is generally necessary to fully understand the impact on the recognition of transactions and to identify areas where material misstatements are likely to arise.

PRACTICAL ADVICE

The documentation on file should contain not only a description of the accounting policy used, but also a description of how that policy is applied and a conclusion on the appropriateness of that policy based on the understanding of the entity, including the terms and conditions of agreements with customers and suppliers.

Analytical procedures

Insufficient or inadequate analytical procedures on income statement items are one of the most common and recurring deficiencies in review engagements. Example of these include the following:

- weak correlations between non-financial information collected as part of the understanding the entity and changes in financial statement balances;
- insufficient analytical procedures performed for a new entity due to the lack of comparative information or because the practitioner had little industry information;

PRACTICAL ADVICE

- Simply calculating a variation is insufficient. An explanation supporting the reasonableness of the amount or balance of the item in the financial statements should be documented.
- The explanations received from the client must be detailed enough to allow the practitioner to assess the reasonableness of the variation. It may therefore be useful to quantify the explanations.

- limited explanations provided where entities operated in volatile or unpredictable industries, such as construction; and
- limited analysis of interdependencies between types of transactions and account balances.

To be relevant and to assist in assessing the existence of material misstatement, analytical procedures must be sufficiently precise and adapted to the specific context of the entity. Key performance indicators (“KPIs”) used by the entity can provide important clues on account balances and may be worth examining.

Comparing the current year’s results with those of the previous year is generally insufficient to provide limited assurance over balances, especially if this comparison is not linked with changes observed in the nature of the entity’s transactions or with the economic trends of its industry.

When inquiry and analytical procedures provide insufficient evidence, additional procedures should be performed. In certain circumstances, procedures similar to audit procedures may be necessary.

Audit engagements

Deficiencies observed in audit engagements are often the result of:

- an insufficient understanding of the entity, its systems and controls;
- an inappropriate assessment of the risks of material misstatement; and
- an inadequate or insufficient execution of key audit procedures.

Other weaknesses noted in audit engagements are described below.

Practitioner’s knowledge of specialized industries

28% of inspections with significant audit deficiencies are caused by insufficient knowledge of specialized sectors (daycare centres, notaries, cooperatives, etc.).

Performing an audit for entities operating in specialized industries requires the acquisition of a sound understanding of these industries, including any legal or regulatory requirements that may:

- have an impact on the presentation of financial information;
- increase the risk inherent to certain types of transactions; and
- require the implementation of sector-specific audit procedures.

In general, the deficiencies noted in audits involving entities operating in specialized industries stemmed from insufficient or inappropriate procedures relating to revenue recognition and liabilities, including provisions.

Before accepting a new engagement, the auditor must ensure that they have the necessary knowledge or that they can be guided, internally or externally, by those who have this knowledge.

Audit of accounting estimates

The audit of estimates often poses a significant challenge to the auditor because of the uncertainty surrounding the assumptions and judgements made by management. In addition, the forward-looking nature of the information used by the entity in its estimation process makes it more complex to validate.

The estimates which most often resulted in deficiencies during inspections were:

- recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree in a business combination;
- the percentage of completion for revenue recognition for long-term contracts; and
- the fair value of non-current assets and estimated future cash flows used in impairment testing.

REMINDER

Significant changes were made to CAS 540, *Auditing Accounting Estimates and Related Disclosures*. The revised CAS 540 applies to audits of financial statements beginning December 15, 2019. These changes will impact all audits, regardless of the type or size of entity audited.

The auditor should ensure that sufficient procedures are performed to validate management's assumptions, since they are based on judgments that may be subject to bias. The use of a valuator or other expert should be considered when auditing complex and significant estimates.

Sampling

Sampling approaches and documentation continues to be an area of focus for inspections as firms often do not document whether the sample:

- is representative of the population being tested; and
- provides sufficient audit evidence concerning the assertion targeted by the test.

Hence, the documentation does not demonstrate whether the sample size reduces the sampling risk to an acceptable level. An appropriate sampling method is key to mitigating audit risks, especially in situations where auditors do not rely on controls. Sample sizes based on professional judgment does not, in and of itself, relieve the auditor from documenting how

PRACTICAL ADVICE

When designing a sample, the auditor should consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. For example, to test the existence of revenue, the sample could be selected from a sales journal reconciled with the general ledger or from the general ledger itself.

the number of tests provides sufficient audit evidence based on the characteristics of the population, the risks and materiality.

Also, in some cases, the source of the population from which the sample was drawn does not provide evidence to address all assertions planned to be tested.

Information produced by the entity

When the auditor uses information produced by the entity (“IPE”) the auditor should obtain audit evidence about the accuracy and completeness of the information. The auditor should not implicitly rely on the systems that generated the information without testing these systems and/or the information. An aged accounts receivable report used for estimating the allowance for doubtful accounts and an inventory turnover report used for estimating inventory provisions are examples of information produced by the entity used in the audit.

PRACTICAL ADVICE

- In planning the audit, consider inventorying the IT systems used in producing financial information and identifying the information produced from these systems that is used for audit purposes.
- The auditor should document the evidence obtained regarding the accuracy and completeness of this information.

Before relying on reports or information produced by the entity, the auditor must perform sufficient and appropriate procedures to ensure there are accurate and complete.

Compilation engagements

Compilation engagements are generally performed and documented in accordance with applicable standards. Nevertheless, where deficiencies are noted, they often relate to a lack of documentation to support the source of the figures presented in the financial statements or to significant mathematical errors and inconsistencies.

In addition, it is important to mention that the new CSRS 4200 standard, *Compilation Engagements*, published in February 2020 in the *CPA Canada Handbook*, will have a significant impact on the planning and execution of these engagements as well as on the wording of the report. This standard, which is effective for the compilation of financial information for periods ending on or after December 14, 2021, may be early adopted. In this context, it is recommended that practitioners familiarize themselves with new standard and take appropriate training to assess the impact of the standard on their practice.

The implementation of AuG-16, *Compilation of a Financial Forecast or Projection*, continues to pose some challenges, although deficiencies were less frequently noted this year. In this regard, it is important to clarify that the compilation of financial forecasts or projections is excluded from the scope of CSRS 4200 and therefore, AuG-16 will continue to apply to these engagements.

Canadian Standard on Quality Control

The Committee noted that some practitioners do not comply with all quality control standards. The most common findings are outlined below.

Lack of ongoing consideration and evaluation of the firm's system of quality control process and lack of cyclical inspections

CSQC 1 requires that the monitoring process of assurance firms include cyclical inspection of completed engagements. The standard does not specifically prescribe how this inspection cycle should be organized but provides that the length of the inspection cycle should be tailored to the firm's client base, including the risks associated with the firm's clients and specific engagements.

In this regard, the Committee continued to note that:

- some firms have not conducted a cyclical inspection for more than four years (this finding is frequently noted for firms that have not fully met the requirements of the professional inspection);
- no action plan is in place to address the deficiencies identified during cyclical inspections; and
- engagement team members are not informed of deficiencies raised and actions to be taken.

Cyclical inspections are more than simply an administrative process—they are a useful risk management tool for firms. The Committee encourages all members to review this important process to ensure that it is carried out in a timely manner by competent individuals and result in concrete action plans.

Lack of review by an engagement quality control reviewer (prior to issuing the report)

In certain firms, a quality control reviewer is frequently not assigned to higher risk engagements or such reviews are performed too superficially. A quality control review performed in a timely manner by a suitably qualified and experienced person can help the engagement team appropriately identify risks and provide an objective perspective on the sufficiency and appropriateness of the audit evidence obtained.

Lack of consultation on complex technical issues

Too often, inspection deficiencies could have been avoided if the engagement team had sought advice from those with specific knowledge of the subject matter. Consultation helps to promote quality and improves the application of professional judgment, particularly when it is carried out with subject matter experts. The Quebec CPA Order’s technical reference service is also available to provide free assistance to members.

Tools to assist you in your commitment to excellence

Maintaining high quality standards allows you to:

- optimize the client experience;
- lower legal and reputational risks;
- facilitate business development; and
- consolidate your firm’s success.

To assist you in providing quality services on an everyday basis, the Quebec CPA Order and CPA Canada offer a variety of resources, including training activities, tools, guides and templates. Consider the following valuable resources to enhance your knowledge related to some of the deficiencies raised during this inspection period.

Quebec CPA Order’s technical reference service

Have questions about accounting and assurance standards in the *CPA Canada Handbook*? We can help you! This service is free and easy to use.

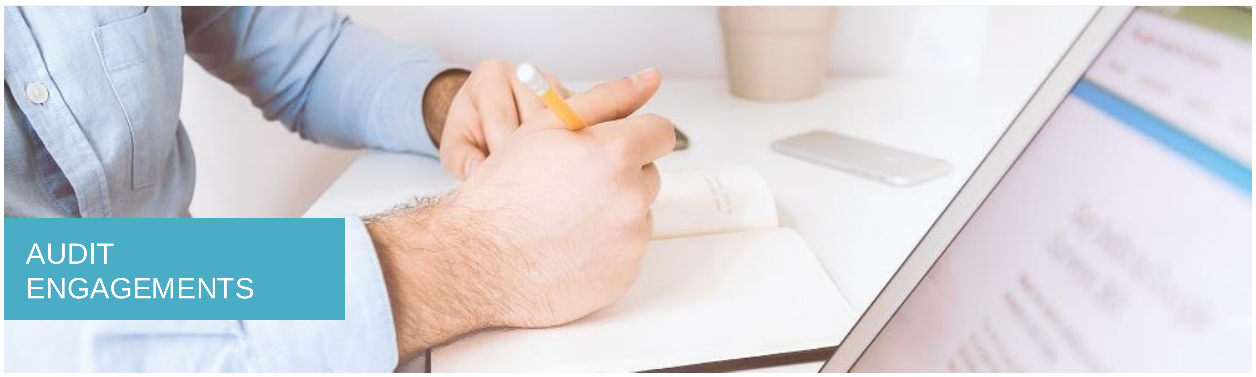
Are you looking for an efficient way to stay up to date with the latest news and trends? CPA Quebec’s ***Expert advice and resources*** web page provides quick access to articles, reporting templates, regulatory updates and best practices. Explore these valuable resources available to you!

Ethics-related questions

Have questions about the Code of ethics? Need guidance on a specific situation? Consult our team. It’s easy and free!

CPA Canada's ***Guide to Review Engagements*** aims to help practitioners conduct review engagements in compliance with CSRE 2400, *Engagements to Review Historical Financial Statements*.

The CPA Canada guide ***Reporting Implications of the Canadian Standard on Review Engagements (CSRE 2400)*** is intended to promote consistency in practitioners' reports by providing guidance with respect to commonly occurring circumstances.



The Quebec CPA Order's ***Atelier pratique – Échantillonnage*** (French only) workshop provides best practices for performing audit sampling procedures and for understanding the impact of sampling on audit risk components.

CPA Canada's ***Framework for Information Integrity Controls*** can help you assess and document your organization's information integrity controls.

The guide ***Implementation tool for auditors: CAS 315 – Understanding the entity through internal control*** raises awareness of common pitfalls auditors might encounter when applying certain requirements of CAS 315 as it relates to obtaining an understanding of the entity's internal control.

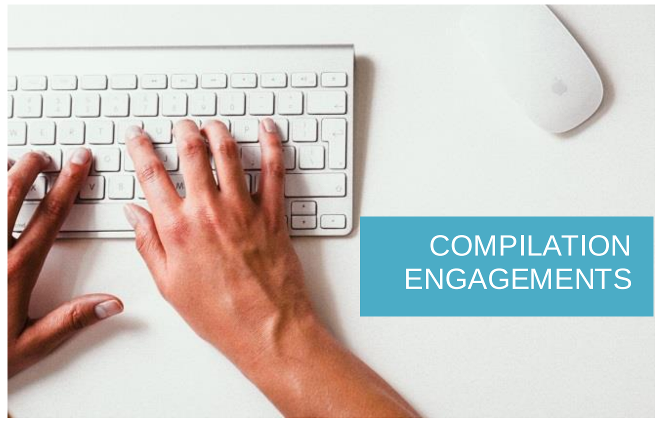
The CPA Canada publication ***Implementation tool for auditors: Designing and performing tests of relevant controls*** alerts you to common pitfalls auditors might encounter when applying certain requirements of CAS 330, *The Auditor's Responses to Assessed Risks*, as it relates to designing and performing tests of relevant controls.

CPA Canada's ***Guide for Auditors: Audits of Not-for-Profit Organizations: Risk Assessment under Canadian Auditing Standards*** addresses key issues likely to arise when applying the risk assessment standards set out in CAS in an audit of an NFPO.

The CPA Canada publication ***Audit and Assurance Alert: Revised CAS 540, Auditing Accounting Estimates and Related Disclosures*** helps you better understand the impact on all auditors resulting from changes to CAS 540, regardless of the size or type of entity whose financial statements are being audited. These revisions are effective for audits of financial statements for periods beginning on or after December 15, 2019. The ***Implementation Tool: CAS 540 revised*** is an indispensable tool to help you correctly apply the new requirements.

The ***Implementation Tool for Auditors: Information Technology – Why Should Auditors Care?*** discusses specific requirements of CAS 330 regarding relevant controls of the entity's information technology (IT) systems and designing and performing tests of their operating effectiveness.

Compilation engagements – Application of the new CSRS 4200 offered by the Quebec CPA Order: This training activity updates practitioners on the new standard for compilation engagements providing them a working knowledge of the standard and its application in practice. The workshop includes an overview of the components of the standard from engagement acceptance to completion and reporting. Major differences from the previous standard will be highlighted and scenarios will be provided to create working paper templates and documents to use as examples in practice.



Practitioners wishing to obtain a general understanding of the requirements of the standard are invited to attend a half-day training course entitled: **Compilation engagements – Overview of the new standard (CSRS 4200)**.

Download CPA Canada's ***Accounting Standards for Private Enterprises (ASPE): Summary Resource Guide*** for a comprehensive listing of CPA Canada's ASPE resources.

Consult ***Accounting Standards for Private Enterprises (ASPE) Briefing: A New Light on Accounting for Investments*** for assistance in the application of sections 1591, 3051 and 3056.

CPA Canada's ***Guide to Accounting Standards for Not-for-Profit Organizations in Canada*** will help you determine if your organization is a private or government-controlled NFP so you can apply the correct accounting standards.

Download ***International Financial Reporting Standards (IFRS): Summary Resource Guide*** for a comprehensive listing of CPA Canada's IFRS resources.

Consult the link ***IFRS 9 Financial Instruments: External Resources***, where CPA Canada has compiled a list of useful external resources to help you understand and apply IFRS 9 *Financial Instruments*.

Also, on its web pages **IFRS 9 *Financial Instruments*: External Resources**, **IFRS 15 *Revenue from Contracts with Customers*: External Resources** and **IFRS 16 *Leases*: External Resources**, CPA Canada has also put together a host useful resources to you help understand and apply these standards.

APPENDIX: Overview of the inspection evaluation process

Impact of the findings noted during professional inspections

The determination of the outcome of the professional inspection and the choice of corrective measures imposed, if any, are based on the assessment of the seriousness of the deficiencies noted, taking into account their impact on the financial statements or on the overall quality of the work performed.

- A firm is considered to have fully satisfied the requirements of the professional inspection when the deficiencies noted do not or could not have a material impact on the financial statements. In these cases, no action plan or other follow-up action is required. The firm will continue its regular inspection cycle unless there are significant changes in its organization or client portfolio.
- In other cases, the Committee may conclude that the firm needs to take specific actions to meet the requirements of the professional inspection program for the current cycle. Generally, the firm will then be required to submit an action plan as well as the projected timetable for the implementation of the actions to correct the items noted in the professional inspection report. Partners of the firm may also be required to commit to one or more professional development courses.

  The Committee may decide to follow-up on certain components of the action plans, in response to specific issues raised during the inspection. For example, when a material misstatement in the financial statements is noted, the firm will need to take actions to correct the situation, either by withdrawing or reissuing its report or by having the client restate the financial statements. The measures taken by the firm will be subject to a post-inspection follow-up, which will incur additional costs for the firm.
- A firm is considered to not have met the requirements of the professional inspection program for the current cycle when significant deficiencies are identified in the recognition of certain transactions or when key procedures have not been performed appropriately or completely in one or more engagements. Such situations will require more significant follow-up action, generally in the form of a supervised internship, a reinspection of engagements with similar issues or a complete reinspection of the firm.

Questions?

To learn more about the inspection process, the program evaluation criteria and remedial actions, and access the tools and reference material available to members, please consult the *Professional inspection* section on the Order's website.

For all other inquiries, please contact the Professional inspection team by phone at 514 288-3256 ext. 2565 or toll-free at 1 800 363-4688, or by email at *inspection@cpaquebec.ca*.