assurance and related services guideline
AuG-17
transactions or conditions reportable under the "well-being reporting requirement" in federal financial institutions legislation

This Guideline is to be read in conjunction with the *Preface to the CPA Canada Handbook – Assurance*.

October 1993 *

INTRODUCTION AND PURPOSE

1. Canadian Standard on Related Services (CSRS) 4460, *Reports on Supplementary Matters Arising from an Audit or a Review Engagement*, deals with circumstances when a practitioner has been requested to accept an other reporting responsibility. The federal acts governing financial institutions 1 contain an other reporting responsibility with respect to any transactions or conditions affecting the well-being of the financial institution that in the auditor's opinion are not satisfactory and require rectification. Without restricting the generality of this other reporting responsibility, the federal acts also require reporting about transactions that in the auditor's opinion have not been within the powers of the financial institution and about loans exceeding a specified percentage of regulatory capital, where, in the auditor's opinion, loss is likely to occur. For the purposes of this Guideline, these reporting requirements are referred to as the "well-being reporting requirement".

2. This Guideline provides guidance to an auditor of a federally regulated financial institution on the types of transactions or conditions that may be encountered during the financial statement audit that would be reportable under the well-being reporting requirement. It may also provide an auditor with useful guidance in addressing similar reporting requirements under other financial institutions legislation.

3. This Guideline should be read in conjunction with CSRS 4460, *Reports on Supplementary Matters Arising from an Audit or a Review Engagement*.

REPORTABLE TRANSACTIONS OR CONDITIONS

4. The transactions or conditions that are reportable under the well-being reporting requirement are:
   (a) transactions or conditions that necessitate a change in accounting basis, or require note disclosure, because of significant doubts about the entity's ability to continue as a going concern;
   (b) other transactions or conditions giving rise to material uncertainties that have the potential to jeopardize the financial institution's ability to continue as a going concern;
   (c) transactions or conditions indicating that the financial institution has significant deficiencies in internal control that render it vulnerable to material uncertainties that have the potential to jeopardize the financial institution's ability to continue as a going concern;
   (d) transactions or conditions necessitating a modification to the auditor's opinion;
   (e) transactions or conditions that indicate lack of good faith by management;
   (f) transactions or conditions contravening legislated capital adequacy or liquidity requirements; and
   (g) transactions or conditions specifically identified in the legislation as reportable.

Transactions or conditions that necessitate a change in accounting basis, or require note disclosure, because of significant doubt about the entity's ability to continue as a going concern

5. The going concern assumption is discussed in CAS 570, *Going Concern*. CAS 570, paragraphs 11 and A7-A15, require the auditor to determine whether there are events or conditions that, individually or collectively, may cast significant doubt on the ability of an entity to continue as a going concern, and, therefore, on the validity of using the going concern assumption in preparing the financial statements. The preparation of the financial statements may be affected to the extent that a change in accounting basis is necessary, or to the extent that note disclosure is required to explicitly draw the reader's attention to material uncertainties related to events or conditions that may cast significant doubt upon the financial institution's ability to continue as a going concern. Transactions or conditions are reportable under the well-being reporting requirement if the auditor concludes that they necessitate a change in the basis of accounting, or otherwise require note disclosure in the financial statements because they may cast significant doubt about the ability of the entity to continue as a going concern. [Former paragraph 5 of AuG-17 retained in Archived Pronouncements.]

Other transactions or conditions giving rise to material uncertainties that have the potential to jeopardize the financial institution's ability to continue as a going concern

6. In considering the events or conditions set out in CAS 570, *Going Concern*, paragraphs 11 and A7-A15, the auditor may conclude that transactions or conditions encountered during the financial statement audit do not affect the validity of using the going concern assumption in preparing the financial statements. However, such transactions or conditions would still be reportable under the well-being reporting requirement if the auditor concludes they represent material uncertainties that have the potential to jeopardize the ability of the financial institution to continue as a going concern. The auditor would determine whether transactions or conditions encountered during the audit involving material uncertainties are reportable under the well-being reporting requirement by:

   (a) identifying the key events or conditions affecting the material uncertainties;

   (b) considering how these events or conditions could change; and

   (c) assessing whether changes that have more than a remote chance of occurring would affect the financial institution to the extent that its ability to continue as a going concern would be jeopardized.

   In making this determination, the auditor would take into account all the evidence obtained during the financial statement audit, including discussions with management on the above matters and management's assessments with respect to them, and the auditor's understanding of the entity and its environment. [Former paragraph 6 of AuG-17 retained in Archived Pronouncements.]

7. Two examples of transactions or conditions involving significant risks or exposures that would be reportable under the well-being reporting requirement are as follows:

   (a) Loans or investments that result in excessive concentration in a particular geographic area or industry sector — In determining whether a concentration is excessive, and thus reportable under the well-being reporting requirement, the auditor would consider whether changes in the area or sector in which the loans or investments are concentrated that have more than a remote chance of occurring would result in losses that would jeopardize the financial institution's ability to continue as a going concern. Further, the auditor would consider:

      (i) the financial institution's ability to mitigate the effects of the concentration through application of risk management policies and procedures;

      (ii) other factors that may diversify the portfolio in ways that mitigate the potential risks associated with the concentration (for example, when a portfolio is concentrated in a particular geographic area, the risk of a potential going concern problem could be mitigated if, within the geographic area, there are categories of loans or investments that respond differently to economic cycles); and

      (iii) the ability of the financial institution to absorb losses that could result from the concentration.

   (b) Loans or investments that result in significant mismatching of assets and liabilities — In determining whether a mismatching is significant, and thus reportable under the well-being reporting requirement, the auditor would consider whether changes to interest rates or exchange rates that have more than a remote chance of occurring would result in losses that would jeopardize the financial institution's ability to continue as a going concern. Further, the auditor would consider:

      (i) the financial institution's ability to mitigate the effects of the mismatching of assets and liabilities through application of its risk management policies and procedures; and

      (ii) the ability of the financial institution to absorb losses that could result from the mismatching.

Transactions or conditions indicating that the financial institution has significant deficiencies in internal control that render it vulnerable to material uncertainties that have the potential to jeopardize the financial institution's ability to continue as a going concern

8. During the financial statement audit, the auditor may become aware of significant deficiencies in the control environment or control systems relating to the management of the risks inherent in the business carried out by the financial institution, such as risks relating to liquidity, interest rates, asset concentration, foreign currency, asset custody, investment valuations, credit granting and underwriting. Such deficiencies are reportable under the well-being reporting requirement if the auditor concludes their existence leaves the financial institution vulnerable to material uncertainties that have the potential to jeopardize the ability of the financial institution to continue as a going concern.

Transactions or conditions necessitating a modification to the auditor's opinion

9. A modification to the opinion on the financial statements of a financial institution is usually a very serious matter, because, among other things, it could affect public confidence in the financial institution. Any transactions or conditions that lead the auditor to conclude a modification to the opinion will be necessary would therefore be reportable under the well-being reporting requirement.

Transactions or conditions that indicate lack of good faith by management

10. CAS 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Canadian Auditing Standards*, paragraph 15, states: "The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated." Transactions or conditions that the auditor concludes indicate lack of good faith by management are reportable under the well-being reporting requirement, because the absence of good faith on management's part could leave the financial institution vulnerable to material uncertainties. Such transactions or conditions include those involving fraud or suspected fraud or

other irregularities at the highest levels of management. For example, during the financial statement audit, the auditor may become aware that management has deliberately issued misleading financial information to regulators or to the public, or has deliberately misled the auditor on important matters. [Former paragraph 10 of AuG-17 retained in Archived Pronouncements.]

Transactions or conditions contravening legislated capital adequacy or liquidity requirements

11. Financial institutions are required by law to meet certain capital adequacy or liquidity requirements. If during the financial statement audit the auditor becomes aware that the financial institution is in contravention of these capital adequacy or liquidity requirements, this would be reportable under the well-being reporting requirement.

Transactions or conditions specifically identified in the legislation as reportable

12. The federal legislation specifically requires the following to be communicated under the well-being reporting requirement:
    (a) transactions of the financial institution that have come to the auditor's attention and that in the auditor's opinion have not been within the powers of the financial institution; and
    (b) except in the case of a property and casualty insurance company, loans owing to the financial institution by any person the aggregate amount of which exceeds 0.5 percent of the regulatory capital of the financial institution and in respect of which, in the auditor's opinion, loss to the financial institution is likely to occur. The legislation further states that, when such a report has been made in respect of loans to any person, it is not necessary to report again in respect of loans to that person unless, in the opinion of the auditor, the amount of the loss likely to occur has increased.

OTHER CONSIDERATIONS

13. The federal legislation does not discuss when a report under the well-being reporting requirement should be issued. However, it is important that, once a transaction or condition is considered reportable, the report be issued on a timely basis to enable recipients to take appropriate action.
14. Transactions or conditions encountered during the financial statement audit would be considered both individually and in combination in assessing whether they would be reportable under the well-being reporting requirement.
15. Except as otherwise provided for in paragraph 12(b), reportable transactions or conditions encountered during the financial statement audit should be communicated even if the auditor believes the parties receiving the report are already aware of such transactions or conditions.
16. The term "auditor" is defined in the federal legislation to include a firm of accountants. Consequently, the individual auditor responsible for the financial statement audit of the financial institution would inform members of his or her firm who provide other services [2] to the financial institution about the well-being reporting requirement and the fact that any potentially relevant transactions or conditions will need to be brought to the individual auditor's attention.

Footnotes

*. Paragraphs 1, 3, 4, 9 and 13 amended in June 2014.

1. The Bank Act, the Insurance Companies Act, the Trust and Loan Companies Act, the Co-operative Credit Associations Act.

2. Includes accounting and other non-audit practice areas such as management consulting and insolvency.
