Assurance

<u>assertion</u>
CAS 315
identifying and assessing the risks of material misstatement

The Use of Assertions

A189. In identifying and assessing the risks of material misstatement, the auditor may use the categories of assertions as described in paragraph A190(a)-(b) below or may express them differently provided all aspects described below have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.

A190. Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

(a) Assertions about classes of transactions and events, and related disclosures, for the period under audit:

E.g. revenue

(i) Occurrence — transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.

(ii) Completeness — all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

(iii) Accuracy — amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

(iv) Cutoff — transactions and events have been recorded in the correct accounting period.

(v) Classification — transactions and events have been recorded in the proper accounts.

(vi) Presentation — transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

(b) Assertions about account balances, and related disclosures, at the period end:

E.g. balance sheet

(i) Existence — assets, liabilities and equity interests exist.

(ii) Rights and obligations — the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness — all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

(iv) Accuracy, valuation and allocation — assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

(v) Classification — assets, liabilities and equity interests have been recorded in the proper accounts.

(vi) Presentation — assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

Procedure

CAS 500 audit evidence

*Audit Procedures for Obtaining **Audit Evidence***

***Inspection**: examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.*

***Observation**: looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of controls.*

***External Confirmation**: direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.*

***Recalculation**: checking the mathematical accuracy of documents or records.*

***Reperformance**: auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.*

Analytical Procedures: evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

***Inquiry**: seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.*

Planning memo

Risk:

The following are risks of material misstatement at the overall financial statement level:

Therefore, the risk of material misstatement at the overall financial statement level is high.

Approach:

(Given this is the first year of operation), we are required to obtain an understanding of the design of the controls.

Weak control environment

There are many control weakness, and therefore the control are determined weak, thus we will take a substantive approach.

Given that there are high volume and routine transactions, we as the auditors would want to take a combined approach to the auditor. However, we cannot test the IT controls because we are past year end.

Given that there are a lot of control weaknesses such as that in the IT system and given that we are not able to test it, we will take a substantive approach.

There is a third party - we will need to obtain additional information based on the controls in place at that organization.

ONLY: First time audit → never been audited before:

Opening balances → We will need to conduct rollback procedures. Given that the audit starts after year end, we may will not be able to get an understanding of the balance for inventory. Hence, we may need to qualify, and therefore need to understand from the users whether they will accept this.

Materiality:

The users of the financial statements are:

User 1 – List the Users Incentive

User 2 – List the Users Incentive

User 3 – List the Users Incentive

We will calculate materiality based on X% of benchmark

We selected this benchmark as the users are interested in profitability/ROI/growth/solvency/performance

We selected the lower range of the benchmark to the sensitivity of users

Common percentages that are appropriate are:

3 – 7% of net income before taxes (normalized)

.5 – 5% of gross profit

.5 – 1% of total assets

.5 – 5% of shareholders' equity (or net asset)

.5 – 1% of revenue

.5 – 3% of expenses (non-profits)

Performance Materiality (PM)

Performance materiality will be calculated at 60-75% of materiality

The users are more sensitive because state reason why users are sensitive → calculate PM

Specific Materiality

There is a lot of sensitivity towards revenue including its recognition so we will set specific materiality at 50% of PM.

Report for Gross Revenues

Audit of CWO
CAS200
3. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with CASs and relevant ethical requirements enables the auditor to form that opinion. (Ref: Para. A1)

Section 5815 - special reports — audit reports on compliance with agreements, statutes and regulations
Section 9100 - reports on the results of applying specified auditing procedures to financial information other than financial statements

Type of Assurance:

Audit – highest level of assurance

- highest cost
- most time consuming

CANADIAN AUDITING STANDARDS
CAS 805
special considerations — audits of single financial statements and specific elements, accounts or items of a financial statement

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Basis for Conclusions
Reporting on Audited Financial Statements (June 2017)
CAS 805, Special Considerations — Audits of Single Financial Statements and Specified Elements, Accounts or Items of a Financial Statement — Basis for Conclusions (September 2009)
(Effective for audits for periods ending on or after December 15, 2018)

CAS 805 contains an effective date that differs, and wording that is amended, from that in corresponding ISA 805. The *Preface to the CPA Canada Handbook - Assurance* provides an explanation.

Type of Assurance

Special-purpose assurance engagement – specific audit procedures

- This does not constitute a complete audit

- Will select procedures that are the most relevant given the risks and general intent of the representations

CANADIAN STANDARD ON ASSURANCE ENGAGEMENTS
CSAE 3530
attestation engagements to report on compliance

Basis for Conclusions

(Effective for attestation engagements to report on management's statement of an entity's compliance when the practitioner's report is dated on or after April 1, 2019)

FOR THOSE WHO CHOOSE NOT TO APPLY THIS CSAE BEFORE THE EFFECTIVE DATE, see Sections 5800, 5815 and 8600 in Archived Pronouncements.

ssues with type of report:

can't verify the opening inventory balances
Difficult to verify the second representation because they will not have been able to obsrve whether all past transactions have been in the ordinary course of business
Must rely on management representation
Difficult to determine what liabilities are not disclosed

Conclusion
Very high-risk engagement because of the nature of the representations, the incompetence of Ryan and the monetary impact on the purchase price
Use the specific procedures

Type of Procedures
Review prior years' files (existence)
Review corporate minute books (existence, rights)
Correspond with legal counsel (existence, completeness, rights)
Correspond with major customer to determine possible returns (completeness, valuation)
Review and attend the inventory count at the effective date (existence, valuation)
Review and verify the inventory costing calculations (valuation)
Review author advances for possible losses (completeness)
Confirm select payables/suppliers (completeness)
Review loan agreements (existence, completeness, valuation)
Confirm loan balances and compliance with convenant (valuation, completeness, rights)
Review contracts with major authors (existence, completeness)

Inspect the contract
Inspect documentation

Level of assurance

Compilation - no assurance provided to the bank that the statements had been prepared in accordance with specific accounting standards (ASPE for example), or that the statements contained no material errors.

Review - limited assurance that the information contained in the financial statements is free from material misstatement.

- Plausibility
- Negative assurance (nothing has come to my attention that leads me to believe

Audit – highest level of assurance

- opinion that the statement are free from material misstatement
- It ultimately reduces the bank's risk since its decisions will be based on financial statements that have been reviewed by a third party.

Cash flow

1. Operating Activities

- Represents cash flows directly related to the company's core business operations.
- Includes:
  - Cash receipts from customers.
  - Cash payments to suppliers and employees.
  - Interest paid and received.
  - Taxes paid.
- Methods of Presentation:
  - **Direct Method:** Lists all major cash receipts and payments.
  - **Indirect Method:** Adjusts net income for non-cash items (e.g., depreciation) and changes in working capital (e.g., inventory, accounts receivable).

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2. Investing Activities

- Reflects cash flows from the purchase or sale of long-term assets and investments.
- Includes:
  - Purchases or sales of property, plant, and equipment (PPE).
  - Purchases or sales of investments (e.g., stocks, bonds).

- Loans made to other entities or repayments received.

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3. Financing Activities

- Involves cash flows from transactions that affect a company's equity and debt.
- Includes:
  - Issuance or repurchase of shares.
  - Borrowings and repayments of loans.
  - Dividends paid to shareholders.

TAX

Acquisition of control

Analysis:
An acquisition of control occurs when an individual/group obtains control of a corporation that is different than the previous individual/group who controlled it
Four implications:
1. Deemed Taxation Year-End one day prior to the acquisition
2. Realization of accrued losses on property when FMV < Tax Cost
3. Net-capital losses are deemed expired
4. Non-capital losses from business operations may be used, subject to restrictions

Section 249(4): Deemed Year-End

- A deemed taxation year-end occurs immediately before the acquisition of control.

Section 111(4): Expiry of Net-Capital Losses

- Net capital losses expire upon an acquisition of control.

Section 111(5): Use of Non-Capital Losses

- Non-capital losses can be carried forward after an acquisition of control but are subject to restrictions.

Section 85

Section 85(1) permits a taxpayer, and subsection 85(2) permits all members of a partnership to elect to defer all or part of the income which would otherwise arise on the transfer of certain types of property to a taxable Canadian corporation.
85 (1) Where a taxpayer has, in a taxation year, disposed of any of the taxpayer's property that was eligible property to a taxable Canadian corporation for consideration that includes shares of the capital stock of the corporation, if the taxpayer and the corporation have jointly elected in prescribed form and in accordance with subsection 85(6), the following rules apply:
(a) the amount that the taxpayer and the corporation have agreed on in their election in respect of the property shall be deemed to be the taxpayer's proceeds of disposition of the property and the corporation's cost of the property;
(c) where the amount that the taxpayer and the corporation have agreed on in their election in respect of the property is greater than the fair market value, at the time of the disposition, of the property so disposed of, the amount so agreed on shall, irrespective of the amount actually so agreed on, be deemed to be an amount equal to that fair market value;

How to make the election:
- Transferor and transferee jointly elect by completing form T2057(or T2058 if transferor is a partnership) by deadline. Subject to late filing penalties if not filed on time.
- Election is due on the first/earliest tax return filing deadline for all the parties involved for the taxation year that includes the transaction.
  - Transferor has April 30 filing deadline and Transferee has June 30 filing deadline while the transfer occurs on January 15, 2017. The deadline would be April 30, 2018 (not 2017).

Elect amount should between ACB and FMV
For **optimal tax deferral**, the strategy is:

1. **Elect the cash (boot) received as the elected amount**, ensuring it equals the **adjusted cost base (ACB)** of the property.
2. Allocate the remaining FMV to shares, which defers the gain.

This approach ensures full tax deferral while setting the stage for future tax planning.

Section 85(1): General Rules

- Permits a taxpayer to defer capital gains on the transfer of eligible property to a taxable Canadian corporation if an election is made.

Section 85(2): Partnership Transfers

- Allows all members of a partnership to transfer property to a corporation under similar deferral conditions.

Subsection 85(6): Election Requirements

- Specifies the joint election requirements and deadlines for filing the election (e.g., Form T2057 or T2058).

Principal residence exemption

Reduce capital gain

The **Principal Residence Exemption (PRE)** is a tax rule in Canada that allows homeowners to shelter capital gains from taxation when they sell their principal residence. This exemption can significantly reduce or eliminate the tax payable on the sale of a property used as their primary home.

Section 40(2)(b): Principal Residence Designation

- Specifies that a principal residence's gain is exempt from capital gains tax.

Section 54: Definition of Principal Residence

- Defines what constitutes a principal residence for tax purposes.

Capital cost allowance

The **Capital Cost Allowance (CCA)** is the tax deduction that businesses in Canada can claim for the depreciation of eligible capital assets. It allows businesses to recover the cost of these assets over time by deducting a portion of their value annually against taxable income.

1. **Capital Assets**:
    - Includes items such as buildings, machinery, vehicles, furniture, and equipment used to earn business income.
2. **CCA Classes and Rates**:
    - Capital assets are grouped into **classes**, each with a prescribed **rate** of deduction (e.g., 20% for Class 8, 30% for Class 10).
3. **Declining Balance Method**:

    - Most CCA deductions are calculated on a **declining balance basis**, where the deduction is based on the remaining Undepreciated Capital Cost (UCC) of the asset.
4. **Half-Year Rule**:
    - In the year of acquisition, only **half** of the net addition to a class is eligible for CCA to prevent over-deduction for assets purchased late in the year.

Section 20(1)(a): CCA Deduction

- Allows taxpayers to deduct CCA from taxable income.

Regulation 1100 & Schedule II: CCA Classes

- Lists the CCA classes and rates (e.g., Class 8 at 20%, Class 10 at 30%).

Small Business Deduction

The **Small Business Deduction (SBD)** is a tax benefit in Canada that allows **Canadian-controlled private corporations (CCPCs)** to pay a reduced tax rate on the first portion of their **active business income (ABI)**. It is designed to support small businesses by lowering their overall corporate tax burden.

the business would meet the requirement of a CCPC:
- A private corporation that is not controlled by: a public corporation or
- a non-resident of Canada

Active Business Income: Business income from any business carried on by the corporation other than a specified investment business or a personal services business:
First $500,000 annually receives the Small Business Deduction ("SBD"):
19% x active business income

Section 125(1): SBD Rates

- Provides the reduced tax rate for the first $500,000 of active business income for a Canadian-controlled private corporation (CCPC).

Definition of CCPC: Section 125(7)

- Clarifies the eligibility criteria for CCPC status.

Non-capital loss

Carryforward Period:

- Non-capital losses can generally be carried forward for **20 years** to offset taxable income in future years.

Carryback Period:

- Non-capital losses can be carried back for up to **3 preceding tax years** to offset previously reported taxable income.

Offset Against Income:

- Non-capital losses can be applied against any type of income (e.g., employment, business, rental, or investment income).

- **Section 111(1): Carryforward and Carryback**
  - Non-capital losses can be carried forward for 20 years and back for 3 years.

Tax implication

Important dates:

- Corporation tax owing is due 2 months after the end of the tax year.
- Corporate Income tax return T2 needs to be filed within 6 months of its tax year end.

Corporations need to register for the collection and remittance of GST/HST. (If not incorporated, need to register for GST/HST if taxable revenues exceed $30,000 in any single calendar quarter or in four consecutive calendar quarters)

Capital Income

Capital income arises from transactions involving **capital property**, such as investments, real estate, or assets held for personal or long-term purposes.

Characteristics:

- **Source**: Generated from the sale or disposition of **capital assets**.
  - Examples: Sale of stocks, real estate, or long-term investments.
- **Nature**: Typically a one-time or infrequent event.

- **Capital Gains**: The profit from selling a capital property for more than its adjusted cost base (ACB).
- **Capital Losses**: The loss from selling a capital property for less than its ACB.

Tax Treatment:

- **Inclusion Rate**: Only **50% of capital gains** are included in taxable income (this is called the **inclusion rate**).
- **Capital Losses**:
  - Can only be applied to offset **capital gains**, not other types of income.
  - Can be carried back 3 years or forward indefinitely.
- **Examples of Capital Property**:
  - Shares of a company.
  - Real estate not used in business.
  - Personal-use property exceeding $1,000.

Business Income

Business income is derived from activities conducted with the intention of earning a profit, typically on a **regular and ongoing basis**.

Characteristics:

- **Source**: Income from operations, sales, or services.
  - Examples: Selling goods, consulting services, or rental property income (if substantial activity is involved).
- **Nature**: Continuous and intentional activity for profit.
- **Active Income**: Includes income earned through regular business activities, as opposed to passive income (e.g., investment income).

Tax Treatment:

- **Fully Taxable**: 100% of business income is included in taxable income.
- **Expenses Deductible**:
  - Expenses incurred to earn business income can be deducted, such as salaries, utilities, rent, and advertising.
- **Losses**:
  - Business losses can offset other income types (e.g., employment or investment income).
  - Can be carried forward 20 years or back 3 years.

- **Section 38: Capital Gains Inclusion Rate**
    - Only 50% of capital gains are included in taxable income.
- **Section 39: Definition of Capital Gains**
    - Specifies what constitutes capital gains and losses.
- **Section 9: Business Income**
    - States that business income is fully taxable and outlines deductions for expenses.

lifetime capital gains exemption (LCGE)

Section 110.6 (LCGE)

Section 110.6:

- Outlines the **Lifetime Capital Gains Exemption (LCGE)** for QSBC shares.

Section 54:

- Defines **Qualified Small Business Corporation Shares** and their eligibility criteria.

Section 70(5):

- Addresses **deemed disposition** upon death, which may reset the ACB to fair market value (FMV).

Section 70 (Deemed Dispositions on Death):

- Discusses adjustments to the ACB when assets are transferred upon death.

Asset Sale Share Sale

Impact for Buyer
Bump up of assets to purchase price which typically reflects FV and therefore able to access larger CCA amounts

No bump up of assets meaning historical basis of tax values remain and therefore smaller tax deductions compared to the asset sale.
Access to previous losses to use deduct against future income

Liabilities Assumed
No liabilities unless specified in the contract
All liabilities assumed
Impact for Seller
Double Taxation at Corporate and Personal level, some gains also may not be taxable at the capital inclusion rate of 50%
Access to LCGE assuming the business qualifies and avoids double taxation

The sale of shares would be more favourable to Mrs. Gillis
- Entire gain would be taxed at capital gains rates
- Utilize the capital gains exemption
- Mrs. Gillis may be able to benefit for a further $500,000 exemption that may not have been triggered on Prof. Gillis' death
- The adjusted cost base of the shares - $1,720,000 = $720K (share capital) + $500k+ $500k

The sale of assets would be more favourable to ACL
- Would be able to get the value in the assets
- Do not take responsibilities for TPI liabilities
- If ACL acquires shares – there is an acquisition of control
- Significant loss carryforwards are available in TPI that ACL might be able to use
- MUST MEET THE SAME OR SMILIAR BUSINESS TEST AND EXPECTATION OF PROFIT
- Deemed disposition of all assets that have inherent non-capital losses

case

Wine:

Memo 1

Viability

Risks
opp

Tax implication

Pertinent industry and corporate information

Opportunities

Threats

Critical success factor

Start up issue

Cost -> expense

Accounting policy

Memo 2

Suggestion on information system

Audit engagement issue:

First time audit

Inexperienced staff

Note:

Control -> weakness, implication, recommendation
audit -> risk, assertion, procedure
Engagement

Financial statement:

- Current ratio
- Gross margin
- Loss
- Receivables

- Debt vs equity -> leverage

We can compare this estimated purchase price to the fair market value of the assets being acquired:

Inventory, lands, buildings and equipment (per appraiser)	$9,400,000
Adjustments:	
Reduce inventory to cost ($2,400-$1,931)	(469,000)
Net financial assets at January 31, 2020	
Current assets (excluding inventory)	3,778,000
Current liabilities	(6,083,000)
Long-term borrowings	(4,230,000)
Deferred taxes	(210,000)
Estimated net asset value	$2,186,000

Acquisition
Quantitative
Purchase price vs fair value of net asset
Purchase price vs present value of cash flow

Qualitative
Risks
Opportunities