ASSURANCE MARKING GUIDE-
SABLETEL

In the assurance role, the candidate is expected to draft the overall audit strategy for the 2014 audit of SableTel's financial figures, including procedures for the high risk areas. As part of the audit, the candidate is expected to address the significant financial reporting errors in the draft financial statements and to consider the impact of the proposed IPO and other transactions on both the consolidated and unconsolidated statements.

Candidates are also expected to provide professional advice regarding SableTel's fee submission to the Canadian Radio-television and Communications Commission (CRTC). They are asked to discuss the type of report and to develop an appropriate strategy.

(Note: Solutions have been created for illustration purposes only. The Board of Examiners will determine the actual number of opportunities and define the expectations that will be part of the assessment to ensure the four roles are equated.)

Memo to: **Langley Markussen**
From: **Assurance CPA**
Subject: **SableTel's 2014 Year-End**

COMMON CORE (Financial Reporting-depth opportunity):
(will be broken down into multiple assessment opportunities by the BOE)

The candidate discusses the significant financial reporting issues related to the 2014 financial statements.

The candidate demonstrates competence in Financial Reporting.

Note: all CPA candidates are expected to achieve the same level of competence for Core Financial Reporting regardless of the role they choose. For purposes of illustration, the same information appears in each of the four Elective role solutions. However, it is possible that in a real case, that the ranking of the issues and the "slant" put on the discussion would be tailored to the role being assumed.

CPA		CPA Competency Statement	Core
1.1.1		Evaluates financial reporting needs	A
1.2.1		Develops or evaluates appropriate accounting policies and procedures	A
1.3.1		Prepares financial statements	A

I have identified the following accounting issues with respect to the 2014 financial statements of SableTel and where possible I have estimated the misstatement. I have then adjusted the financial statements as presented to better reflect the actual financial condition and financial results of SableTel for its 2014 fiscal year.

Issue #1 -Inventory – obsolescence provision

Guidance for accounting for inventory can be found in IAS 2 - Inventories

Inventory at SableTel consists of routers and modems that SableTel sells to its customers. Total inventory at August 31, 2014 had a book value of $3,219,431. The continuity of the inventory for the 2014 fiscal year can be presented as follows:

Inventory – Opening	$	883,318
Purchases – Discounted Product		2,500,000
Purchases – Other (Regular)		515,972
Cost of Sales – Routers and Modems		(679,859)
Inventory – Closing	$	3,219,431

The inventory level at year end would appear to be extremely high and may require write-down. The main reason for the substantial increase in inventory relates to the $2,500,000 of inventory which was purchased in September 2013. Given that the inventory tends to have a short life (typically 12 months), it is not clear why SableTel would purchase such a large quantity of inventory as its annual sales do not justify such a large purchase. It is now twelve months after this discounted product was purchased and therefore it is likely that much of this inventory can no longer be sold.

Sales of routers and modems for the 2014 fiscal year totaled $1,675,759. The costs associated with these sales totaled $679,859. Assuming similar sales in future years, SableTel has inventory on hand at August 31, 2014 which represents 4.74 years of sales ($3,219,431/$679,859). Given that these items have a short life (typically 12 months), a portion of the inventory is likely obsolete and requires write down. Further details would need to be gathered regarding the specific inventory items to determine an accurate obsolescence provision, but as an initial estimate, we could assume that items representing sales greater than one year will likely require a write down. Therefore the estimated obsolescence provision is $2,539,572 ($3,219,431 - $679,859). SableTel would potentially need to reduce its inventory balance on the financial statements by $2,539,572 and increase its cost of sales by a similar amount (see the adjusted financial statements below).

Issue #2- Deferred Research and Development Costs

Guidance for research and development costs can be found in IAS 38 – Intangible Assets

Deferred research and development costs represents costs associated with the Wireless Technology Project from 2013 and 2014 that have been capitalized. The amounts have been capitalized as management has “declared its intention to carry this project to market”. However, this is only one of the criteria that must be met in order for research and development costs to be capitalized.

IAS 38 paragraph 57 states:

"An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development."

SableTel clearly does not meet all of the criteria for recognition as an intangible asset.

The first criterion requires that the technical feasibility be assured. However, Dan has indicated that SableTel is currently awaiting a third party feasibility study for this project. Therefore it is unlikely that this criterion has been met at year end.

The second criterion requires an intention to complete the intangible asset. Management has indicated that they intend to complete the Wireless Technology Project so this criterion is likely met.

The next criterion requires SableTel to prove that it will use or sell the intangible asset. We can assume that this criterion is met and the Industry Canada grant may provide further evidence supporting this criterion as Industry Canada wants to use the technology (indicating that SableTel may be able to sell the technology as well.)

The fourth criterion requires management to demonstrate how the asset will generate probable future economic benefits. SableTel will utilize the wireless technology internally, presumably to decrease costs and increase margins. Therefore SableTel likely meets this criterion as the technology is supposed to increase margins by 5% across all of its product lines. This would provide substantial benefits (5% of $65 million is $3.25 million on an annual basis). SableTel would need to provide some evidence to support this assertion. This may be available once the third party feasibility assessment has been completed.

The fifth criterion requires adequate technical, financial and other resources to complete the project. Dan has indicated that SableTel does not currently have the financial resources to finish this project and requires funding from StarNova to complete the project. Therefore this criterion is likely not met currently as StarNova has not committed itself to the funding. However, should SableTel be able to provide support that StarNova or some other source will fund the remainder of the project then this criterion may be supportable.

Finally, SableTel must be able to demonstrate that it can measure reliably the expenditures attributable to the project. It is not clear if SableTel can do this. Dan has indicated that accounting came up with the $22 million necessary to complete the project but he is not sure how they came up with this number. As well, SableTel would also need to demonstrate that it had the necessary systems in place to track the costs associated with this project reliably. Therefore this criterion may be met but more information is required.

Since all six criteria must be met in order to capitalize the costs and at least two of the criteria are likely not met, the costs cannot be capitalized and must be expensed. As a result SableTel should reduce the deferred research and development costs from $9,160,250 to Nil and increase administration expenses by the same amount (see the adjusted financial statements below).

Even if SableTel met all of the criteria for capitalization of the development costs, it would not be able to go back to 2013 and capitalize those research and development costs in 2014. IAS 38 paragraph 71 states **"Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date."**

From a presentation standpoint we would also recommend that consideration be given to separating the research and development costs from the administration expenses on the face of the statement of comprehensive income as it is a significant amount and is likely of interest to users of the financial statements.

Issue #3- Industry Canada Grant

Guidance for government assistance can be found in IAS 20 – Accounting for government assistance and disclosure of government assistance.

There are two issues associated with the government grant. The first issue is whether SableTel has met the criteria for recognition of the government grant. IAS 20 paragraph 7 states:

"Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received."

SableTel has received the $2,750,000 so we can safely state that the second criterion has been met. However, it is not clear if the first criterion, related to satisfying all of the conditions attached to the grant has been met. There is some evidence that the conditions have not been met as SableTel must share its technology with Industry Canada (IC) and IC must formally approve the technology. However, we would need to gather further details relating to the grant in order to determine if the first criterion has been met and as a result if the amount can be recognized.

Assuming that the above two criteria have been met then the second issue regarding the government grant relates to its presentation. IAS 20 paragraph 24 states:

> "Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset."

This government grant relates to the Wireless Technology Project. This project was initially recorded as an intangible asset. If the Wireless Technology Project was still recorded as an asset then SableTel would need to reverse the amount recorded as revenue and record the amount as either deferred income or by deducting the amount from the carrying value of the Wireless Technology Project.

However, due to the adjustment discussed above (see Deferred Research and Development Costs), the Wireless Technology Project would now be expensed as administration on the statement of comprehensive income. The presentation of grants related to income is discussed in IAS 20 paragraph 29 which states:

> "Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense."

I would recommend that the amount be recorded as a reduction of the related expense as it is clearly attributable to these expenditures. Therefore, the amount would be removed from revenue and recorded as a reduction of the research and development expenses (administration expenses) on the statement of comprehensive income (see the adjusted financial statements below). Note that the adjustment will have no net effect on the profit (loss) of SableTel.

Issue #4- Impairment of Mobile Network

Guidance for the impairment of assets can be found in IAS 36 – Impairment of assets.

In August 2014, Hurricane Baylee damaged several of the communication towers associated with SableTel's mobile network disabling the entire network. In total 60 of the 340 towers were damaged. Each tower has a carrying value of $35,000.

SableTel must determine if the communication towers require a write down at year end.

IAS 36 paragraph 9 states:

"An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Clearly there is an indication that the assets may be impaired as the towers have been damaged. Therefore SableTel should estimate the recoverable amount.

IAS 36 paragraph 18 states:

"This Standard defines recoverable amount as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use."

IAS 36 paragraph 22 states:

"Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs
65–103), unless either:

(a) the asset's fair value less costs to sell is higher than its carrying amount; or
(b) the asset's value in use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined."

It would appear from the facts of the case that the towers, as a whole, make up a cash-generating unit as the entire mobile network has been disabled by the damage to 60 of the towers. Therefore it may be necessary to estimate the recoverable amount for the entire mobile network (i.e. the 340 communication towers) and not just the 60 towers that have been damaged.

IAS 36 paragraphs 66 and 67 state:

Paragraph 66 – "If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit)."

Paragraph 67 – "The recoverable amount of an individual asset cannot be determined if:

(a) the asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

(b) the asset does not generate cash inflows that are largely independent of those from other assets.

In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit."

As stated above, there are two possible ways to determine an assets (or group of assets) recoverable amount. The first is to determine the assets fair value less costs to sell. We do not have a lot of information to determine this amount but it is unlikely that SableTel could sell the damaged towers for any significant amount. As well there is no indication that SableTel could sell its entire mobile network but it is possible that another telecom company may want this network. The mobile network, in its current state has no value as the entire mobile network has been disabled. It is important to note that the value in use is generally determined by its estimated future cash flows in its *current condition*. IAS 36 paragraph 44 states:

> "Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:
>
> (a) a future restructuring to which an entity is not yet committed; or
>
> (b) improving or enhancing the asset's performance."

SableTel has indicated that it is unclear if the mobile network can be fixed. It is also contemplating replacing the entire tower system with a new faster system. Therefore it is unclear what the recoverable amount of the towers, or the entire system (the cash-generating unit) is at year-end.

I believe that there is likely some impairment within the mobile network. Further information would need to be gathered to determine the exact amount of the impairment but as an estimate we could approximate that the recoverable amount of the 60 damaged towers is likely NIL. The total for these six towers would be $2,100,000 (60 X $35,000) (see the adjusted financial statements below).

Note that it is possible that all 340 towers and the entire mobile system (the cash-generating unit) would need to be written down to NIL or the estimated recoverable amount (fair value less costs to sell) as the mobile network has no value in use based on its current condition. It is also not clear if the network can be fixed, or even if it can be fixed, if SableTel plans to repair the network. If the mobile network cannot be sold (i.e. the fair value less costs to sell is minimal) and SableTel does not plan to fix the network, then the entire network should be written down to NIL. At a minimum this amounts to $11,900,000 (340 towers X $35,000 per tower) for the towers and may need to be higher if there are additional capital assets associated with the mobile network. At this point we will assume that the 280 towers that were not damaged would not require a write-down as they may have a fair value in the open market or may be able to generate positive cash flows in the future.

Any write-down should be recorded as an impairment loss as stated in IAS 36 paragraph 59:

> "If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss."

We should also inquire to determine if there are any insurance proceeds that are likely to be received as a result of the damaged tower. Any proceeds would reduce the loss.

As well, given that SableTel is contemplating replacing the entire system, it would be prudent to analyze the estimated useful lives of the assets in question and/or the residual values.

Deferred Revenues (minor issue)

There are no deferred revenues on the face of the statement of financial position. Given the nature of the company, a telecommunications company, we would expect that certain of its revenues would be billed in advance (i.e. it is typical for companies in this industry to bill a month of service in advance and some also require substantial deposits). This should be investigated further. It is possible that this amount is buried in the Trade and other payables line item on the statement of financial position. It is also possible that these amounts have been incorrectly recorded as revenues. Further information would need to be gathered to determine any error that exists.

Issue #5- CRTC Fee

We have recalculated the estimated misstatement in the 2013 and 2014 CRTC Fees. The total estimated misstatement is $1,193,619. Of this amount $672,218 relates to 2013 and $521,401 relates to 2014. The amount relating to 2013 ($672,218) is an accounting error and as such the amount should be added to accrued liabilities and should reduce the 2014 opening retained earnings. (Note: IAS 8 would require work to be done on the comparative amounts too.) The amount for 2014 ($521,401) should be added to cost of sales (CRTC Fee) and be added to accrued liabilities at August 31, 2014 as this amount relates to the 2014 fiscal year.

Preliminary Estimate of Error

We have been asked by John to determine a preliminary estimate of the error. This calculation is based on preliminary information.

Description of Input	**2014 Calculation**	**2013 Calculation**
Revenues from long-distance, local and mobile services (see Note 1 to the financial statements)	$ 56,857,395	$ 60,712,173
Less: Related Party Revenues (assume = $0)	0	0
Less: Qualifying Costs (see Note 2 to the financial statements)	(25,215,367)	(25,333,908)
Add: Fees paid to non-Canadian entities (see Note 2 to the financial statements)	897,500	788,000
Add: 200% of negative margin customers (assume that the finance database is correct and assume 2013 = $0)	2,260,000	0
Add: Related Party Costs (see Note 2 to the financial statements)	1,357,850	1,458,760
Fee Base	36,157,378	37,625,025
Contribution Rate	12%	12%
Preliminary Fee Calculation	4,338,885	4,515,003
Fee as Calculated	3,817,484	3,842,785
Adjustment Required	$ 521,401	$ 672,218

Issue #6- Adjusted Financial Statements

The financial statements for 2014 will require adjustment due to the cumulative material effect of the misstatements noted above. The following schedule estimates the potential adjustments to the financial statements:

Item Description	2014 Actual F/S's (unadjusted)	Required IFRS adjustments	JEs	2014 Actual F/S's (adjusted)
Current assets				
Cash	$ 351,018			$ 351,018
Accounts receivable	15,864,501			15,864,501
Inventory	3,219,431	(2,539,572)	**1**	679,859
Total Current Assets	19,434,950	(2,539,572)		16,895,378
Property, plant and equipment	62,532,502	(2,100,000)	**4**	60,432,502
Deferred taxes	35,629			35,629
Intangible assets	10,753,709	(9,160,250)	**2**	1,593,459
Total Assets	$ 92,756,790	(13,799,822)		$ 78,956,968
Current liabilities	$ 22,265,938	1,193,619	**5**	$ 23,459,557
Long-term debt	44,152,572			44,152,572
Total Liabilities	66,418,510	1,193,619		67,612,129
Total Shareholders' Equity	26,338,280	(14,993,441)	**(A),5**	11,344,839
Total Liabilities and Shareholders' Equity	$ 92,756,790	(13,799,822)		$ 78,956,968
Revenue	$ 65,072,224	(2,750,000)	**3**	$ 62,322,224
Cost of sales	30,714,869	3,060,973	**1,5**	33,775,842
Gross profit	34,357,355	(5,810,973)		28,546,382
Expenses:				
Selling and marketing	16,875,413			16,875,413
Administration	13,336,292	8,510,250	**2,3,4**	21,846,542
Interest expense	2,967,650			2,967,650
Total Expenses	33,179,355	8,510,250		41,689,605
Profit (loss)	$ 1,178,000	14,321,223	**(A)**	$ (13,143,223)

The adjusted financial statements present a much different financial picture for SableTel for its 2014 fiscal year. These adjusted financial statements should be utilized when analyzing SableTel for any further analysis, as well as for our materiality calculation

Journal Entries (JEs)

JE #	Account Description	Debit	Credit
1	Cost of sales (routers and modems)	$ 2,539,572	
1	Inventory		$ 2,539,572
	To set-up a provision for inventory obsolescence		
2	Administration (R&D expenses)	$ 9,160,250	
2	Intangible assets		$ 9,160,250
	To reverse expenditures associated with the Wireless Technology Project that were capitalized		
3	Revenue (Government Grant)	$ 2,750,000	
3	Administration (R&D expenses)		$ 2,750,000
	To reclassify the Industry Canada grant received during the year		
4	Administration (Impairment charge)	$ 2,100,000	
4	Property, plant and equipment (Mobile Network Towers)		$ 2,100,000
	To record an impairment charge on the mobile network towers		
5	Cost of sales (2014 CRTC Fee adjustment)	$ 521,401	
5	Retained earnings (opening – 2013 CRTC Fee adjustment)	672,218	
5	Current liabilities (accrued liabilities)		$ 1,193,619
	To record the estimated misstatement in the CRTC Fee for 2013 and 2014		

Assurance (will be broken down into multiple assessment opportunities by the BOE)

The candidate provides a draft of the overall audit strategy for the 2014 SableTel audit

CPA		CPA Competency Statement	Core	E3 As
4.3.1		Assesses issues related to the undertaking of the engagement or project	B	A
4.3.2		Assesses which set of criteria to apply to the subject matter being evaluated	B	A
4.3.3		Assesses or develops which standards or guidelines to apply based on the nature and expectations of the assurance engagement or project	B	A
4.3.4		Assesses materiality for the assurance engagement or project	B	A
4.3.5		Assesses the risks of the project, or for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances, and disclosures	B	A
Also draws upon Core (Finance) in performing the analytical review:				
5.1.1		Evaluates the entity's financial state; subsection a) performs financial analysis including ratio analysis, industry benchmarking, trend analysis and cash flow analysis; subsection c) draws conclusions as to the entity's financial state	A	NA

SableTel Audit – Unconsolidated

Issue #1- Agreeing to the Terms of the Audit Engagement

We need to first determine whether preconditions for an audit are present.

1. Because SableTel's financial statements have been prepared in accordance with IFRS since 2012, we have met the criteria of an acceptable financial reporting framework for preparation of the financial statements
2. We will need to obtain management's agreement that it acknowledges and understands its responsibility, including responsibility for preparation of the financial statements, internal controls as well as auditor access to information.

An immediate meeting with Dan Wilson and SableTel's financial team will be especially important given Dan's comments regarding his expectation of that our audit staff will not ask too many questions this year. In order to undertake this audit engagement, we will need to be clear that although there are limited resources in the Finance area of SableTel, we will require unrestricted access to financial records and documentation, as well as individuals who will provide additional information required to obtain audit evidence. We cannot accept this audit engagement if Dan Wilson continues to suggest that there will be limitations in the scope of our anticipated audit procedures.

CAS also requires that we communicate our responsibilities as auditors with those charged with governance of SableTel. In this case, because SableTel is a 100%-owned subsidiary of StarNova, this communication would be with the management (or perhaps the board of directors/audit committee) of StarNova.

Issue #2 – Materiality and Risk

Materiality

Because we normally do not issue a separate opinion on the financial statements of SableTel, we have applied StarNova's materiality in our previous engagements related to SableTel. For purposes of consolidation, we will again apply materiality of $4 million as it relates to the consolidation of SableTel's results with the parent company.

For the SableTel audit (unconsolidated), we will need to set a separate lower materiality, considering the potential users of these financial statements, most notably potential investors in the company. Because SableTel Limited has experienced swings in its profitability (profit in 2014, but net loss in 2013), it is more appropriate to use the more stable revenue figure when setting the preliminary materiality level. A common range for materiality is 0.5% to 2.0% of revenue, and due to the expected scrutiny of potential investors, I will use the lower level for the 2014 audit – 0.5% x $62,322,224 (adjusted for estimated errors) = $311,611. We will use an approximation of $310,000 for purposes of our audit.

We will also need to consider whether there are particular classes of transactions, account balances or disclosures for which a lower materiality level would be warranted. Because of the possibility of license revocation related to the CRTC fee for 2013 and 2014, materiality will be lower for this item and will be analyzed separately as part of the special engagement.

Performance materiality will be set lower than $310,000 to allow for potential misstatements. We will review last year's audit file to determine the carryforward unadjusted misstatement from last year's audit and will also need to consider anticipated misstatements from specific audit tests. This will be a matter of professional judgment after review of our experience in previous audits. Of course, planning materiality will be adjusted if new information comes to light during our audit that would impact our assessment of this figure.

Preliminary Assessment of Audit Risk Factors

Because the audited financial statements of SableTel may be used as part of an initial share offering, is it important that we reduce the risk of material misstatement to a sufficiently low level such that an incorrect purchase decision would not be made by potential investors. This low level of acceptable risk will impact the amount of audit evidence required.

There is potential for bias in SableTel's financial statements. SableTel is expecting significant capital funding from StarNova in the near future (or will raise capital with a share offering), and may wish to demonstrate positive financial performance in order to gain the confidence of the parent company or new investors in a funding decision. Given the very optimistic reporting of 2014 results in the Executive Reporting Document, we will want to be alert to potential asset or income overstatement.

An area of concern is the comment by Dan Wilson regarding the loss of key finance staff. It is worrisome that SableTel is having difficulty paying bills and this might be one of the reasons for the significant increase in payables compared to the prior year. This will need to be an area of audit focus. In addition, we should question whether there have been additional impacts to financial reporting caused by the staffing shortage. We will need to increase audit focus on year-end accruals of expenses and payables in case some have been delayed and missed (we will be especially concerned with cutoff of transactions and completeness of payables). We will need to determine if other financial statement balances have been impacted as well, then make any necessary adjustments to our assessed risk of material misstatement for other specific assertions.

Although there is concern regarding the possibility of unrecorded payables, the balance in the trades and other payables account has actually increased substantially since the prior year. The cash balance is much lower than last year, and it appears that there are significant current assets "tied up" in accounts receivable and inventory. We will need to assess the ability of SableTel to meet its current obligations; there could be potential concern regarding the company's short-term liquidity. This is tempered by SableTel's ability to borrow from the parent company, but is an area of concern and increases the level of risk related to our audit work on SableTel.

Of significant concern is the suggestion by the CEO that he would not expect us to need to collect additional evidence, nor work with the finance staff to complete our audit work. It is imperative that we set up a meeting with Dan Wilson as quickly as possible to ensure that he is aware of our requirements, and to make certain that SableTel staff is willing and able to provide the documentation and explanations we require in order to provide evidence regarding the fairness of the financial information.

Issue #3- Analytical Procedures for Purposes of Risk Assessment

The variance analysis provided by Dan Wilson is not at all helpful to our audit. It is not detailed enough to provide audit evidence in relation to the reported statement of comprehensive income figures, nor even to assist with analytical procedures for purposes of risk assessment. We will therefore perform our own analytical procedures to identify areas of potential risk of material misstatement. Note that this analysis compares the 2014 figures to only the most recent fiscal year (2013)

	2014 Amount	2013 Amount	Variance	% change
Revenue	$ 65,072,224	$ 65,176,742	$ (104,518)	(0.2%)
Cost of sales	30,714,869	30,591,682	123,187	(0.4%)
Expenses				
Selling and marketing	16,875,413	16,583,825	291,752	1.8%
Administration	13,336,292	16,411,245	(3,074,953)	(18.7%)
Interest expense	2,967,650	2,877,850	89,800	3.1%

We can use notes 1 and 2 to disaggregate revenue and cost of sales by product line, and also compare gross margins, in order to identify areas where the figures appear unusual and contain potential misstatement:

Revenue Category	2014 Amount	2013 Amount	Variance	% change
Long-distance	$ 28,050,628	$ 33,069,103	$ (5,018,475)	(15.2%)
Local access	24,567,800	23,679,870	887,930	3.7%
Mobile	4,238,967	3,963,200	275,767	7.0%
Internet and data services	3,789,070	2,896,739	892,331	30.8%
Routers and modems	1,675,759	1,567,830	107,929	6.9%
Industry Canada grant	2,750,000	-	2,750,000	100.0%
Total	$ 65,072,224	$ 65,176,742	$ (104,518)	(0.2%)

Cost of sales Category	2014 Amount	2013 Amount	Variance	% change
Long-distance	$ 11,943,020	$ 12,561,728	$ (618,708)	(4.9%)
Local access	11,067,818	10,684,562	383,256	3.6%
Mobile	2,204,529	2,087,618	116,911	5.6%
Internet and data services	1,002,159	795,119	207,040	26.0%
Routers and modems	679,859	619,870	59,989	9.7%
CRTC Fee	3,817,484	3,842,785	(25,301)	(0.7%)
Total	$ 30,714,869	$ 30,591,682	$ 123,187	(0.4%)

Note that the cost of sales for the routers and modems category in the above analysis has not been increased by the $2,539,572 representing the suggested adjustment for obsolete inventory at August 31, 2014. This has not been done as this adjustment is considered an isolated adjustment and would not provide any further meaningful information for this analysis. Similarly the CRTC Fee has not been adjusted for the proposed adjusting entry. If the CRTC Fee had been adjusted based on the adjustment proposed above then the 2013 CRTC Fee would be $4,515,003 ($3,842,785 + $672,218) and the 2014 Fee would be $4,338,885 ($3,817,484 + $521,401) which equates to a decreased Fee of $176,118 or 3.9%. This is reasonable given the decreased sales.

While the individual variances for revenues and cost of sales provides some additional detailed variance information, an analysis of the gross margins for each category by product line may provide even more information. This information is readily available by combining the information in Notes 1 and Note 2 as follows:

Product Category	2014 Gross Profit	2014 Gross Margin %	2013 Gross Profit	2013 Gross Margin %	Change in Margin
Long-distance	$ 16,107,608	57.4%	$ 20,507,375	62.0%	(4.6) p.p.
Local access	13,499,982	54.9%	12,995,308	54.9%	0.0 p.p.
Mobile	2,034,438	48.0%	1,875,582	47.3%	0.7 p.p.
Internet and data services	2,786,911	73.6%	2,101,620	72.6%	1.0 p.p.
Routers and modems	995,900	59.4%	947,960	60.5%	(1.1) p.p.
Total	$ 35,424,839	56.8%	$ 38,427,845	59.0%	(2.2) p.p.

p.p. = percentage points

Note that the Industry Canada grant and the CRTC Fees are not included in the above analysis as they do not directly relate to one another and a comparison would not provide any useful information.

From the gross margin analysis we can see that the long-distance services, in addition to losing substantial revenues, have a significantly lower gross margin percentage in 2014 compared with 2013. This is very troubling. For this product category the analysis indicates that sales volumes are decreasing and costs (as a percentage of sales) are increasing.

The other product lines seem to have held their gross margins or are very close. Therefore we have narrowed down the significant negative variances identified primarily to the long-distance services. This will be an area of audit emphasis.

Expenses – Dan has noted that there is a positive variance of $2,784K related to decreased expenses. However, no further details have been provided. Dan has indicated that this is likely due to cost containment in the marketing area.

From the draft financial statements and the related notes (Appendix I) we can further determine the source of this variance. From the draft statement of comprehensive income we can see that the variance is actually the result of positive variances in the administration expenses totaling $3,074,953 ($16,411,245 - $13,336,292) offset partially by a negative variance in the selling and marketing expenses of $291,588 ($16,875,413 - $16,583,825). Therefore Dan’s explanation of this variance being the result of cost containment in the marketing area is likely not accurate.

Note 5 provides further information on the administration expenses. This note indicates that $9,160,250 of R&D expenditures have been capitalized in 2014. In prior years R&D expenditures were expensed in the administration line item. If the R&D costs were expensed in 2014 like they had been in prior years (and as we have proposed in our adjusting journal entries) then the administration expenses in 2014 would actually have increased by $6,085,297 ($3,074,953 less $9,160,250). This represents a significant increase in administration expenses over the prior year and needs to be investigated further. Certainly one explanation for this large negative variance is the increased expenditures on the Wireless Technology Project which increased by $2,244,530 in 2014 ($5,702,390 in 2014 vs. $3,457,860 in 2013). However, this is only one part of the negative variance and the remaining negative variance should be researched further. We would need more details on the expenses for 2014 and 2013 to pinpoint additional sources of this variance. This will be identified as an area of audit risk.

- Other variance – Dan has explained that he believes that the other negative variance of $90K is made up of “smaller expense items such as lower depreciation”. However, this is not the source of the variance. The variance is made up completely of the negative variance of $89,800 ($2,967,650 - $2,877,850) in interest.

Issue #4- Control Environment at SableTel

We know that StarNova’s subsidiary businesses operate independently and with a great deal of freedom. Even more so than in prior years, the subsidiary companies, including SableTel, have very few reporting requirements to the parent company. Given that SableTel management met with StarNova’s Executive Committee (EC) only once in the past fiscal year (September 2014), we are not able to rely on monitoring by the parent company for purposes of our audit of SableTel’s financial results. In addition, a focus on an “entrepreneurial” attitude (and anticipated growth) as well as an expectation of a return on StarNova’s investments that surpasses their respective weighted average cost of capital (WACC) would potentially divert attention away from financial monitoring and control on the part of the SableTel CEO and his management team.

It appears that SableTel management does not have an adequate process to identify business risks, including those that would be significant to the financial reporting process. The SableTel Executive Reporting Document refers to a decrease in risk profile, and refers to decisions over the past year that have decreased the company’s overall risk. However the risks that they have identified relate to health risks and not financial risks that would be more useful for the readers. SableTel does not seem to grasp the risk concept from a financial perspective. From a financial perspective it would appear that SableTel’s financial risk has actually increased over the past year as represented by its increased leverage.

There are also concerns regarding SableTel’s information systems. As part of the CRTC fee calculation, separate reports were generated by IT for the Finance and Marketing departments, providing different figures and results. We will need to determine if either of these systems feed into the General Ledger, and obtain an understanding of the information system relevant to SableTel’s financial reporting process.

Due to the above items, the control environment of SableTel may not provide an appropriate foundation for the other components of internal control. Although it is often preferable to rely on internal controls for the testing of many financial statement assertions (especially given our tight deadline on this audit), we will need to carefully consider whether or not this reliance would be appropriate. Further investigation and inquiry will be required and, of course, specific controls will need to be tested.

Additional Considerations

There are additional considerations that should be undertaken as part of the planning specific to the SableTel audit work. These include:

- Staffing – because the experienced audit senior is unable to participate in the audit of SableTel, we will need to ensure that the engagement team has the appropriate competence and capabilities to complete the audit work. Ensuring that some of the team members have previous experience with this client and/or the telecommunications industry will be necessary.
- Timing – because the StarNova audit committee is meeting on October 20, 2014, we have a very tight deadline to complete our consolidated audit of SableTel's financial information and ensure the figures are ready for consolidation. We have not yet even completed the planning portion of the audit work. The impending deadline adds to the necessity for previous client experience on the audit team to ensure the work is done properly and efficiently. We will need to clarify whether or not the audit of the unconsolidated financial statements of SableTel will also need to be complete by October 20. If so, with the increased audit procedures required due to the lower materiality level, we will have a great deal of difficulty with completion of the required procedures. A possibility is to complete our audit of SableTel balances to the parent company's materiality ($4 million) for purposes of consolidation in time for the October 20 deadline; and then perform the additional procedures necessary to issue our audit opinion on the SableTel unconsolidated financial statements after that point. This approach to engagement timing would require immediate communication with our client.
- Opening Balances – Although SableTel's opening balances were audited by our firm, they were audited to the higher materiality of the parent company. We will need to determine whether or not we can obtain sufficient audit evidence related to the opening balances. Further audit procedures may be required on the opening figures.

- Comparative Information – There are two different broad approaches: corresponding figures and comparative financial statements. For corresponding figures, the auditor's opinion refers to the current period only. For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented. We will need to determine which of these approaches will be taken on this engagement. If we will refer to the comparative financial statements in our opinion, additional audit work will be required to ensure that the comparative information is not materially misstated. If both years of comparatives are to be included and reported on in the audited financial statements, this would impact our workload and would likely prove very difficult given our tight audit deadline. If the financial statements are presented with comparatives in similar detail as the current year, and we are unable to provide audit assurance on those comparatives, we will need to state in an Other Matter paragraph that the comparative financial statements are unaudited. Note that our engagement letter as well as written management representations must clearly include the responsibilities of the auditor and management in this regard, and must clearly reflect the approach taken related to comparative information.

Assurance (will be broken down into multiple assessment opportunities by the BOE)

The candidate recommends audit strategy for the high risk areas.

CPA		CPA Competency Statement	Core	E3 As
4.3.5		Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures	B	A
4.3.6		Develops appropriate procedures based on the identified risk of material misstatement	B	A

Specific Areas of Audit Focus – Risk of Material Misstatement in SableTel

Planning materiality has been set at $310,000.

Issue #1-Accounts receivable

The account balance is material ($15.8 million) and has more than doubled compared to the previous year. As this increase is not due to a related increase in revenues (which have slightly decreased from last year), we have identified this as a risk area and will need to specifically focus on the existence assertion as well as valuation of the A/R balance and related allowance for doubtful accounts. We will also need to determine whether the recent staffing situation in the Finance department has led to some of the increase; perhaps collection efforts have been reduced – this is often a very time-consuming activity.

Audit approach:

- Confirmations are a reliable, objective method to test A/R existence. However, we have a very tight deadline so will need to consider if we would receive responses from SableTel customers quickly enough to obtain the evidence required. Alternatively, we could examine subsequent cash receipts as evidence of A/R existence.
- Valuation of A/R should be verified through careful analysis of the allowance for doubtful accounts to ensure its adequacy. We will compare the aging schedule to previous years and determine if there have been any changes. We will also compare the allowance to the historical uncollectible accounts, as evidenced by the eventual write-offs. Our concern is that the growing A/R balance may be due to a higher proportion of older receivables, which would warrant our careful audit attention, as this would require an increase in the allowance and related bad debt expense.

Issue #2- Inventory

The draft inventory balance is above our materiality level. Given the unusually large purchase of inventory a year ago of $2.5 million (far higher than the cost of the routers and modems sold of $679,859), we will be very concerned with the valuation of this item. It is likely that a provision for obsolescence and related write-off will be required, as was calculated and discussed earlier in this memo.

Audit approach:

- I am assuming that we did not attend the inventory count, therefore we will have to do alternate procedures to test this account balance. The large purchase should be quite easily verified to the invoice or invoices to gain assurance as to inventory existence.
- In terms of testing the valuation assertion, which is our main concern, we will need to determine the age of the inventory and discuss with management the likelihood of sale. Even if the inventory might be eventually sold, it is likely to be heavily discounted. Therefore, we will need to determine the appropriate net realizable value and ensure that there is a provision for obsolescence if required.

Issue #3-Property, plant and equipment

This item is very material to the StarNova financial statements and therefore will require our attention for SableTel's audit. We will need to look at the depreciation claims, and this year will also look further at valuation given the damage to 60 of SableTel's communication towers – these assets will need to be tested for impairment. A potential write down of $2.1 million (60 towers with a carrying value of $35,000) would be significant.

Audit approach:

- We will follow our usual audit procedures for the most part. To start, we will obtain a schedule from the client detailing the changes from the prior year. Additions will be agreed to documentation (invoices, payroll records, etc.) and we will obtain evidence in support of cost capitalization. We will also perform audit procedures to determine if disposals were correctly accounted for, and review management's depreciation calculations and related assumptions regarding residual values and useful lives.

- We are also concerned with the valuation of the property, plant and equipment especially as it relates to SableTel's communication towers that were recently damaged. As there is indication of possible impairment, we will need to carefully review and corroborate what management did and the assumptions they made related to the damaged towers. Recognition of an impairment loss may be required.

Issue #4- Intangibles

Intangible assets are always at risk of misstatement as they are valued based on management estimates and judgment. For the 2014 audit, we will focus our attention on the deferred research and development costs as this is a new account balance and it exceeds both SableTel's and StarNova's materiality. Approximately $5.7 million of the balance represents costs incurred in 2014 related to SableTel's Wireless Technology Project.

Audit Approach:
- From an audit standpoint, we will need to ensure that these costs have correctly met the criteria for capitalization (note that our previous analysis suggests that this will not be the case). In addition, it is clear that we will need to work with SableTel management immediately to correct the significant accounting error related to their reversal of 2013 expensed costs, which is clearly in contravention of the accounting standards.

Issue #5-Trade and other payables

As previously identified in the preliminary risk assessment, we will pay attention to the completeness assertion for the payables account. Due to the staffing shortage, we are concerned that some of the payables and related expenses may have been missed at year-end.

Audit Approach:
- Staffing shortages can result in a breakdown of internal controls. We will need to determine whether internal controls have been functioning properly throughout the entire year. If not, we will need to increase our substantive procedures related to A/P as well as the related expense accounts in order to reduce the risk of material misstatement to an acceptably low level.
- To test A/P for completeness, we will need to perform a search for unrecorded payables. This will involve examination of cash disbursements subsequent to year-end, as well as an examination of bills not yet paid (given that the client has indicated they are "scrambling" to pay the bills.

Issue #6-Long-term debt

Long-term debt is material and has increased by almost $4 million.

Audit Approach:
- We will need to agree this increase to the contractual agreements and payment transactions and we will also need to ensure the correct classification between current versus long-term.
- We should determine whether there are any covenants related to this debt and make certain that there are no breaches by SableTel.

Issue #7-Opening Balances

- We will need to perform audit procedures to obtain sufficient, appropriate audit evidence that the opening balances do not contain material misstatements
- For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.
- It may be difficult to design audit procedures related to existence and valuation of inventory on hand at the beginning of the period to take into account our lower materiality level. If we are unable to satisfy ourselves through reliance on documentation, audit procedures around analysis of gross profit and other possible audit work, then we may have to consider a modification of our audit opinion.
- For non-current assets, such as property, plant and equipment, and intangible assets, we may be able to obtain sufficient audit evidence by examination of accounting records of previous periods.
- We likely confirmed the entire balance of long-term debt in prior years, due to the materiality of the balance, even for purposes of consolidation of SableTel's information, where the materiality is set at a higher level.

Issue #8-Statement of comprehensive income accounts

As indicated earlier in my memo, we will not be able to utilize management's variance analysis to provide reliance over the statement of comprehensive income balances. Because Dan Wilson does not appear to have a good understanding of the reasons for the variances in these figures, we will need to place additional audit effort into the revenue and expense accounts, especially in the long distance area where we identified an unusual gross margin change, therefore potential for misstatement. We may be able to rely to some degree on internal controls around these transactions, but will need to be diligent due to the concerns raised in regards to certain control environment elements as well as possible problems with the information systems.

The administration expenses, specifically, appear much lower than last year, however the variance appears to be almost entirely due to the reversal of expense research and development costs related to the intangible assets.

In addition, we will want to ensure the appropriate accounting related to the government grant due to potential sensitivity of this item in terms of government oversight. However, through the consolidation process with StarNova, specific note disclosure will not be required related to this item, as it is immaterial from the perspective of the consolidated entity.

Audit approach:

- It would be very beneficial from an audit efficiency perspective if we could rely on internal controls related to statement of comprehensive income accounts, as the individual transactions are numerous (especially as they related to revenue and cost of sales). We will begin work to determine whether or not this will be possible; specifically, we should immediately begin to investigate whether or not the financial reporting system is reliable. In addition, although Dan Wilson's lack of understanding suggests that the higher-level managerial controls may not be reliable (and we have other concerns related to the control environment as well), there could be control activities that might reduce the risk of material misstatement for certain specific assertions. As indicated earlier in my memo, we will need to carefully consider whether control-reliance is appropriate this year.
- In terms of substantive work, we should ask SableTel's management to undertake a much more detailed variance analysis than the one provided by Dan Wilson, preferably broken down by product line, with explanations as to unexpected or unusual differences from the prior year. We should ask for an equivalent balance by product line for the prior year, as these figures would have been audited. [With the lack of appropriate detailed monitoring to the budget during the year, it would not be helpful for our audit to compare the 2014 actual figures to budget.] We can then utilize the variance analysis as a starting point in performance of substantive analytical procedures to identify areas where additional audit work is required, and follow up with tests of details where necessary.
- We will pay special attention to the assertions of revenue occurrence (related to A/R existence as discussed above) and expense completeness (related to payables completeness). These will be tested indirectly with the related statement of financial position accounts.

Issue #9-Other areas of audit attention

The following items will not be our main focus as I've assessed the risk of material misstatement lower than those discussed above. However, we will want to consider the following:

- The deferred income tax asset is the same as the prior year. The client has likely not yet calculated the correct income tax expense impacts in 2014. This will likely be immaterial on the statement of financial position, with no income tax expense to be reported due to the previous year's loss, but should be brought to management's attention.
- The CRTC fee may be incorrect, so a financial statement adjustment might be required. Because of the impending audit deadline, we will likely not complete the detailed work required of the 2013 CRTC fee recalculation or the 2014 calculation until after completion of the financial statement audit of SableTel. However, we should ensure a preliminary calculation is complete and determine whether or not a financial statement adjustment will be required. If the estimated adjustment would be significantly less than StarNova's materiality of $4 million, we will need to inform the StarNova audit engagement team of the unadjusted misstatement. In addition, we will need to consider the possibility that note disclosure of the CRTC regulation violation might be required. If SableTel were to have its operating license revoked, this would materially impact the future financial results of the consolidated entity. However, given that SableTel fully intends to correct any errors in previous fee calculations, and submit 2013 and 2014 fees in accordance with CRTC requirements by the deadline imposed, we would likely conclude that risk of revocation of SableTel's operating license is not a probable outcome.

- We will also need to work with the StarNova audit engagement team to ensure that all of the required information has been provided in order to create the appropriate and complete note disclosures for the consolidated entity.

Assurance (will be broken down into multiple assessment opportunities by the BOE)

The candidate discusses valid engagement and reporting options for the CRTC special engagement.

CPA		CPA Competency Statement	Core	E3 As
4.2.1		Advises on an entity's assurance needs	B	A
4.3.1		Assesses issues related to the undertaking of the engagement or project	B	A
4.3.2		Assesses which set of criteria to apply to the subject matter being evaluated	B	A
4.3.3		Assesses or develops which standards or guidelines to apply based on the nature and expectations of the assurance engagement or project	B	A
4.3.10		Draws conclusions and communicates results	B	A

SableTel has received a letter from the CRTC which has threatened to revoke its operating license based on the 2013 CRTC Fee as calculated by SableTel. The letter, dated September 5, 2014, requires SableTel to recalculate and submit its 2013 Fee as well as calculate and submit its 2014 Fee by November 30, 2014. As SableTel could not operate without a license, this matter requires our immediate attention.

Given the seriousness of the issue raised by the CRTC, and the severe ramifications of failing to correctly submit the CRTC fee, we could suggest to SableTel management that additional assurance could be provided to the CRTC by including an engagement report prepared by CPA LLP. Although it doesn't appear that this has been formally requested by the CRTC, it would be a logical outcome of our engagement work plan and the conclusions reached as a result of that work.

Depending on the level of assurance desired, we could complete either a special assurance or a review engagement.

Issue# 1-Special Assurance Engagement

If SableTel wishes to provide a higher level of assurance on the CRTC fee submissions, we could complete the engagement and issue a report according to CAS 805 (Special Considerations – Audits of Single Financial Statements and Special Elements, Accounts or Items of a Financial Statement) or Section 5815 (Special Reports – Audit Reports on Compliance with Agreements, Statutes and Regulations).

As the auditors of SableTel, even though it is for purpose of the consolidated entity, we are in a position to be able to undertake this additional engagement as we have knowledge of the entity, its internal controls and information systems, as is required to provide assurance related to the specific elements under audit. In addition, we may be able to use evidence obtained from our financial statement audit for this engagement as well. However, given that the materiality will be much lower for this engagement, this will affect the required level of our understanding, as well as the extent of audit testing required.

We would need to clearly understand and be able to communicate the criteria established by the provisions of the CRTC Fee regulation, especially if we intend to refer to the provisions in our audit opinion. We may also wish to add an Emphasis of Matter paragraph to our audit report alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.

Review Engagement

A review engagement report could be provided if a lower level of assurance is desired. In this case, we could look to Section 8500 (Reviews of Financial Information Other Than Financial Statements) or Section 8600 (Reviews of Compliance with Agreements and Regulations) for guidance. The procedures
are less rigorous compared to those performed for an audit. They include mostly making enquiries of management as to how it calculated the figures in the Fee calculation as well as performing analytical procedures on the reasonableness of the numbers. However, reliance only on management enquiry may not be appropriate in this case, as it is very important to SableTel's continuing operations that the Fee calculations are accurate. Although a review would be less time consuming and therefore less costly than an audit, review procedures would likely not provide our client the support and assurance required.

My recommendation for SableTel is that we undertake a special assurance engagement. The implications of failing to correctly calculate and submit the CRTC Fee are severe. In addition, the level of detail required to verify the calculations requires detailed audit procedures, especially given the apparent errors made by SableTel previously.

Assurance (will be broken down into multiple assessment opportunities by the BOE)

The candidate provides an audit strategy related to the CRTC Fee, including preliminary recalculation of the CRTC Fee (a special engagement) and provides auditing procedures to test the accuracy of the Fee calculation.

CPA		CPA Competency Statement	Core	E3 As
4.3.4		Assesses materiality for the assurance engagement or project	B	A
4.3.5		Assesses the risks of the project, or, for audit engagements, assesses the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures	B	A
4.3.6		Develops appropriate procedures based on the identified risk of material misstatement	B	A
4.3.7		Performs the work plan	B	A
4.3.8		Evaluates the evidence and the results of analysis	B	A
4.3.9		Documents the work performed and its results	B	A
4.3.10		Draws conclusions and communicates results	B	A

We have been asked to plan an engagement strategy for SableTel's 2013 CRTC resubmission and 2014 CRTC submission including a preliminary estimate of the error.

As this will be a separate engagement from our usual audit of financial information for StarNova consolidation, a separate engagement letter will be required, clearly articulating the responsibilities of management and our firm, including the expected form of any reports to be issued.

Issue #1- Audit Strategy

The CRTC requires telecommunications companies to contribute a portion of their "Adjusted Margin" to a fund administered by the CRTC. The CRTC changed the calculations associated with this Fee on September 1, 2012. It would appear that SableTel did not change the way that it calculated this Fee and therefore is in violation of the CRTC requirements based on its 2013 submission. Its calculations and submission have been based on the rules in effect before September 1, 2012.

Overall Risk

The risk associated with this engagement is high as the CRTC license is required in order for SableTel to continue operations. Should SableTel submit an inaccurate or incomplete Fee, there is a significant risk that the CRTC will revoke the operating license of SableTel forcing it to shut down its business (at least temporarily).

Preliminary Materiality

Given the sensitive nature of this engagement, the overall high risk associated with the engagement and the scrutiny that this engagement will receive from its key users (the CRTC and the EC), preliminary materiality should be set at a low level. I will determine preliminary materiality based on 1% of the 2013 Fee as originally calculated by SableTel. 1% of $3,842,785 is $38,428. Materiality will be initially set at $38,000 and should be reviewed during the engagement to ensure it is still appropriate. Performance materiality will be lower to allow for unanticipated misstatements.

Approach/Understanding the Environment

The approach to the assurance over the components of the CRTC Fee can be a combination of substantive and compliance procedures. The use of compliance testing will be tempered with the knowledge that there are discrepancies between the Finance and Marketing customer databases. Tests will need to be designed to determine if these systems feed into the General Ledger, and if they do, whether the systems are accurate or not.

First, an accurate and full understanding of the rules for the calculation will need to be determined. The information that is available must be verified with documentation from the CRTC that defines the calculation. It is likely that there is signed communication from the CRTC that will detail the impact of the changes to the calculation to SableTel. If not, the CRTC can be contacted to ensure the most up to date information is utilized. It may also be advisable to confirm with the CRTC whether the calculation should be based on financial information using International Financial Reporting Standards or another appropriate basis of accounting such as Canadian Accounting Standards for Private Enterprise (ASPE).

We will need to perform a detailed review of the systems and controls over the data used in the calculation and perform walkthroughs of the key controls. Since the 2013 and 2014 financial statements of SableTel are audited for the purpose of consolidation with the parent company, from the financial statement audit, we will already have some assurance that the financial accounting systems are producing accurate results. However, the systems will have been audited only at the level required for the consolidation (with a much higher materiality) and therefore this may not provide a great deal of comfort over SableTel's systems.

Other Planning Considerations

There are additional considerations that should be made during the planning phase of this engagement. These include:

- Staffing – the engagement must be staffed by individuals with the appropriate experience to perform the engagement. If necessary, the engagement team will need to be trained with respect to the CRTC Fee. Appropriate supervision also needs to be ensured.
- Timing – the deadline presented by the CRTC appears to be realistic (November 30, 2014) but we will likely be unable to begin much of the detailed work until after completion of the financial statement audit (after the audit committee meeting for StarNova on October 20, 2014). The engagement must be completed before this deadline and an adjusted submission prepared.

Preliminary Estimate of Error

We have been asked to determine a preliminary estimate of the error. This calculation is based on preliminary information and the main purpose of this calculation is to determine if a material misstatement is likely. This may influence the remaining planning activities for the engagement and may also influence the audit procedures suggested. See Financial Reporting section – under CRTC for calculations. .

From the calculations it is apparent that the Fee as calculated is materially misstated. Adjustments will be required to the submission based on our preliminary estimate of the error.

Issue #2- Specific Procedures

There are many audit procedures that would need to be performed to ensure that the CRTC Fee calculations are not materially misstated. Many of these procedures would be similar to any audit engagement and in these cases, we can use our standard audit programs for these procedures. In addition to these standard procedures, we should perform the following procedures which have been tailored to this unique engagement:

Risk Areas	Assertion	Specific Risks	Procedures/Extent
Revenues are misstated	Occurrence	Bad Debts are not removed from sales (if allowed under the CRTC licence).	We will need to find out how any amounts that have been written off during the year (i.e. bad debts) are handled in the calculation. It is possible that SableTel will be allowed to offset revenues with these bad debts. We can select a sample of bad debts and ensure they have been approved as write-offs. Then we can trace them through the appropriate systems to ensure they offset the revenues in this calculation.
	Accuracy	Arithmetical errors are included in the Fee calculation.	Test the overall mechanical accuracy of the Fee calculation and ensure that the proper calculations have been made by tracing the amounts back to the definitions in the licence. Ensure the new rate of 12% is included in the calculations and not the old rate of 10%.
	Accuracy	Negative Margin Customers – The General Ledger is not reflecting the underlying entries of the proper database.	Test the accuracy of the upload from the billing system into the General Ledger. It is possible that there are some inaccuracies, given the discrepancies in the databases for the negative margin customers, so additional work may need to be performed to ensure that the uploads are accurate. Select a sample of invoices from the billing system and trace them through to the general ledger to ensure they are recorded properly.
	Classification	Revenues include services not included in the CRTC calculation.	The formula specifies that only revenues associated with long-distance, local access and mobile services need to be included in the calculation. It would appear as though SableTel's general ledger (based on Note 1 to the financial statements) can track revenues in this fashion. We will need to test a sample of the revenues to source documentation to ensure the system is accurately tracking revenues by product line.

Risk Areas	Assertion	Specific Risks	Procedures/Extent
	Classification	Related party revenues are incorrectly included in the calculation.	The amount of revenues received from related parties will need to be determined to ensure that they are properly excluded. The starting point will be any working papers prepared for the external auditors and the preparation of the financial statements at year end. The audit team will need to compare the definition of related parties for regulatory purposes to determine if the same companies that were considered related parties for financial statement purposes are considered related parties for regulatory purposes. Note that this is a new exclusion as of September 1, 2012 and therefore is a high risk area of the audit.
Qualifying Costs are misstated	Accuracy	Negative Margin Customers are not identified or are recorded inappropriately.	Testing negative margin customers will be difficult. There are already indications that discrepancies exist between the database used by Marketing and the database used by Finance. Therefore it is unlikely that the audit team will be able to rely on the systems and will have to use a substantive approach. The first step may be to review the licence with the CRTC to clarify what amounts are considered negative margin amounts for purposes of the CRTC calculation. Select a sample of inputs into each database and trace the amounts back to source documentation. This procedure will attempt to verify if one of the databases is accurate by performing manual recalculations on a sample basis. If one of the databases proves to be reliable using the sample, then this is the system that should be used for further testing.

Risk Areas	Assertion	Specific Risks	Procedures/Extent
	Accuracy	Foreign exchange amounts have not been properly calculated.	There is evidence that some of the purchases have been made in U.S. dollars. We need to test these purchases, and any balances outstanding at year end, to ensure the amounts have been translated into Canadian dollars using the appropriate exchange rates and the resulting foreign exchange gain or loss has been properly recorded.
	Classification	All non-Canadian costs are not captured.	We will also need to determine if there are any transactions with non-Canadian entities. First, we will need to determine the definition of non-Canadian entities for regulatory purposes. Then we can scan the purchase documents or disbursement journals for any amounts paid to non-Canadian entities. We could then ask for a report based on the addresses of payees from the payables system, because the address would be a good indication of whether the payee is Canadian resident. The report would show all payments to all payees with non-Canadian addresses. We could test the accuracy of the report through a sample. We could also enquire of management in charge of the purchasing function if there are other suppliers that are non-Canadian that are not on the report, or if there are payees on the report that are resident in Canada but that have a non-Canadian mailing address for some reason.

Risk Areas	Assertion	Specific Risks	Procedures/Extent
	Classification	All related party costs are not captured.	Finally we should determine what costs included in the qualifying costs above were paid to related parties. We can use the list of related parties that was generated for the sales testing to identify the appropriate related parties. Then we can exclude these costs from the calculation. During the revenue testing (above) there should be a comprehensive list of related parties documented. This list should be used to test for additional related party costs. The source documents, such as a purchase journal or similar document, could be scanned for related party purchases.