

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO
THE CHARTERED ACCOUNTANTS ACT, 1956

DISCIPLINE COMMITTEE

IN THE MATTER OF: Charges against **DONALD M. SMITH, CA**, a member of the Institute, under **Rule 206** of the Rules of Professional Conduct, as amended.

TO: Mr. Donald M. Smith, CA
Wedgbury Smith Bonebakker LLP
369 King St. West, PO Box 369
Bolton, ON L7E 5S1

AND TO: The Professional Conduct Committee, ICAO

REASONS
(Decision And Order Made February 3, 2005)

1. This panel of the discipline committee of the Institute of Chartered Accountants of Ontario met on February 3, 2005 to hear charges brought by the Professional Conduct Committee against Donald M. Smith, a member of the Institute.
2. The Professional Conduct Committee was represented by Ms. Barbara Glendinning. She was accompanied by Mr. Ray Harris, the investigator appointed by the Professional Conduct Committee.
3. Mr. Smith was present at the hearing and was represented by Ms. L. Harmer.
4. The decision and order of the panel were made known at the hearing. The formal, written decision and order was signed by the secretary to the discipline committee and sent to the parties on February 10, 2005. These reasons, given in writing pursuant to Bylaw 574, set out the charges, the decision and the order, as well as the reasons of the discipline committee.

CHARGES

5. The Notice of Assignment Hearing dated September 29, 2004, the Notice of Hearing dated October 28, 2004, and the charges dated September 20, 2004, were entered as Exhibits 1, 2 and 3, respectively.
6. Before Mr. Smith pleaded to the charges, the Professional Conduct Committee withdrew particular (d) of charge No. 3. The amended charges read as follows:

1. THAT the said Donald M. Smith, in or about the period March 31, 2003 through June 17, 2003, while engaged to perform an audit of the financial statements of Caledon Information & Community Services O/A Caledon Community Services for the year ended March 31, 2003, failed to perform his professional services in

accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206 of the rules of professional conduct, in that:

- (a) he failed to properly disclose revenue recognition as it related to contributions;
 - (b) he failed to ensure that the representations of management set out in the representation letter dated June 7, 2003 included all required disclosures; and
 - (c) he failed to properly document items important to support his report.
2. THAT the said Donald M. Smith, in or about the period May 31, 2003 through September 15, 2003, while engaged to perform an audit of the financial statements of the Royal Canadian Legion of the British Empire Service League, Bolton Branch for the year ended May 31, 2003, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206 of the rules of professional conduct, in that:
- (a) he failed to properly account for revenue recognition as it related to contributions;
 - (b) he failed to ensure that the representations of management set out in the representation letter dated September 17, 2003 included all required disclosures; and
 - (c) he failed to properly document items important to support his report.
3. THAT the said Donald M. Smith, in or about the period May 31, 2003 through July 21, 2003, while engaged to perform a review of the financial statements of Total Crane Erectors Ltd. for the year ended May 31, 2003, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206 of the rules of professional conduct, in that:
- (a) he failed to ensure adequate and complete disclosure of related party transactions;
 - (b) he failed to properly disclose the required basis of accounting for income taxes;
 - (c) in Note 9 “net changes in non-cash working capital balances”, he included items which were not presented as current assets on the balance sheet;
 - (d) he failed to properly document items important to support his report.

7. Mr. Smith entered a plea of guilty to each of the charges as amended and acknowledged that he knew he could be found guilty on the basis of his plea alone. It was also made clear on the record that while Mr. Smith had entered a plea of guilty he did not agree that particular (b) of

Charge No. 1 or particular (b) of Charge No. 2 constituted professional misconduct. With respect to both particulars he accepted the facts alleged to be true but denied those facts constituted professional misconduct.

EVIDENCE

8. Ms. Glendinning gave a brief opening statement and filed a Document Brief as Exhibit 4. She also filed the CV of Mr. Ray Harris, FCA as Exhibit 5. Mr. Harris was the only witness called on behalf of the Professional Conduct Committee. In giving his evidence he took the panel through the Document Brief.

9 The charges relate to three clients – two audit clients and a review client. The charges are mainly disclosure and documentation related, including:

- failure to properly disclose revenue recognition for contributions
- failure to ensure that the management representation letters contained all required disclosures
- failure to document items important to support his reports
- failure to provide adequate and complete disclosure of related party transactions
- failure to properly disclose the basis of accounting for income taxes

10. Mr. Harris was appointed by the Professional Conduct Committee to investigate Mr. Smith's practice following a second reinspection by the Practice Inspection Committee. He was asked to review one audit file (from the reinspection) and two files chosen at random (one audit file and one review file). A charge resulted from the investigation of each of the files.

11. Mr. Smith is a partner in the small firm of Wedgbury Smith Bonebakker LLP in Bolton, Ontario. His practice consists of a small number of audit clients, about 25 review clients, some compilation clients and tax work.

12. The first charge relates to the file selected from the second reinspection by the Practice Inspection Committee. The audit client is Caledon Information & Community Services O/A Caledon Community Services. The first particular of the charge relates to improper and inadequate disclosure with respect to revenue recognition on contributions in the notes to the financial statements (CICA Handbook section 4400). Mr. Smith did not provide a schedule showing changes in deferred contributions subject to restrictions. Mr. Smith claimed this was an oversight. The second particular relates to inadequate disclosure in the management representation letter relating to frauds and suspected frauds (CICA Handbook section 5135). Mr. Smith was unaware that the Handbook requirements had changed until he took a professional development course in November 2003 through the Institute. He has now amended his template for these letters and the revised template complies with the *Handbook* requirements. The third particular of the charge relates to failure to disclose a contingent liability in the notes to the financial statements relating to a potential legal claim.

13. The second charge relates to another audit client – Royal Canadian Legion of the British Empire Service League, Bolton Branch. The first particular of the charge relates to accounting for revenue from contributions (CICA Handbook 4400 and 4410). Mr. Smith disclosed that the deferral method of accounting was used when in fact the restricted fund method was used. Mr. Smith claimed this was an oversight. The second particular is similar to the second particular of the first

charge, inadequate representations in the management representation letter. The third particular relates to the lack of substantive procedures on expenses.

14. The third charge relates to a review client – Total Crane Erectors Ltd. The first particular relates to disclosure of related party transactions (CICA Handbook 3840). Mr. Smith did not disclose the nature of the relationship between the related parties, nor did he disclose the terms of the amounts due. The second particular of the charge relates to failure to properly disclose the required basis of accounting for income taxes. Mr. Smith was not aware that the tax allocation basis was no longer appropriate. The third particular of the charge relates to an inconsistency between the notes to the financial statements and the balance sheet with respect to non-cash working capital items. Mr. Smith claimed this was a mistake. The last particular relates again to the lack of procedures on expenses.

15. Mr. Smith advises the panel that he has started to take professional development courses. He acknowledges that he was out of date on accounting and auditing matters and that his professional development in recent years had focussed on tax matters.

16. He also advises that he has made changes in his practice since the second reinspection and the investigation by the Professional Conduct Committee.

17. Another matter came up in the cross-examination of Mr. Smith that, in the opinion of the panel, could have been added to the third charge. The comparative financial statements of Total Crane were restated by Mr. Smith. No indication of the restatement appeared in the financial statements or in the notes. Mr. Smith again claimed this was an oversight.

Submissions

18. Counsel for the Professional Conduct Committee submits that the evidence proves that Mr. Smith is guilty of the charges.

19. Ms. Harmer advises us that where she and the Professional Conduct Committee differ is whether the particulars of the first two charges relating to the management representation letters constitute professional misconduct. She argues that the requirements that resulted in the charges were new and that Mr. Smith made changes to the letter template as soon as he became aware of the Handbook changes.

DECISION

20. With respect to Ms. Harmer's submissions concerning the management representation letters, while the panel agrees that these particulars may not, on their own, constitute professional misconduct, the particulars are consistent with the other particulars of the charges in that they demonstrate that Mr. Smith was making little, if any, effort to keep up to date on accounting and auditing requirements. Upon deliberation, the panel concludes that all of the allegations set out in the charges have been proven and that the failures to adhere to the standards of the profession, which are apparent from the particulars of the charges, constitute professional misconduct.

21. Upon resuming the hearing, the chair read the following decision into the record:

THAT, having seen, heard and considered the evidence, particular (d) of charge No. 3 having been withdrawn, and having heard the plea of guilty to charges Nos. 1, 2 and 3, as amended, the Discipline Committee finds Donald MacKenzie Smith guilty

of charges Nos. 1, 2 and 3, as amended.

SANCTION

Submissions of the Professional Conduct Committee

22. The Professional Conduct Committee submits that the most important sanctioning principles in this case are specific deterrence and rehabilitation, and that the penalty being suggested is intended to balance the member's rehabilitation with the risk to the public. The Professional Conduct Committee is convinced that Mr. Smith is a prime candidate for rehabilitation. As a result, it recommends a sanction consisting of a reprimand, professional development courses in the areas of financial statement presentation and auditing, supervised practice on review and audit engagements for 12 months, a reinvestigation of the member's practice following the period of supervised practice, normal publicity, and costs. Ms. Glendinning argues that the components of the recommended order, taken as a whole, provide an appropriate sanction for Mr. Smith's misconduct.

23. The Professional Conduct Committee submits that Mr. Smith's practice should be supervised for a period of 12 months following the filing an approved supervised practice plan. All review engagements and audit engagements with year ends falling within the period of supervised practice should be approved by a supervisor. As well, Mr. Smith should be required to file a supervised practice plan within a defined period of time, which sets out the name and detailed responsibilities of the supervisor. The responsibilities of the supervisor should include a review and approval of Mr. Smith's working papers and financial statements prior to Mr. Smith's issuance of the audit and review reports.

24. After the conclusion of the period of supervised practice, the Professional Conduct Committee recommends there be a reinvestigation of Mr. Smith's practice in order to measure his rehabilitation.

25. The Professional Conduct Committee recommends an order for costs in the range of \$5,000 to \$10,000. We were advised that the costs incurred on a partial indemnity basis amounted to approximately \$16,000. These costs include costs of the investigation, an estimate of hearing preparation costs of counsel for the Professional Conduct Committee, hearing costs of the investigator, counsel for the Professional Conduct Committee, and counsel for the discipline committee and court reporter costs.

26. Ms. Glendinning also referred us to several precedent cases including *Grossi*, *Allouba*, *Hyun*, *McInnis* and *Gray*. Unlike some other standards-related cases, the Professional Conduct Committee is not seeking a suspension in this case because of the age of the member, the fact that Mr. Smith has not been subject to discipline proceedings before, the charges related primarily to documentation issues, the conduct of Mr. Smith did not involve moral turpitude and there are significant other costs involved in the order requested relating to supervised practice and professional development courses.

The Member's Submissions

27. Ms. Harmer argued that supervised practice is not necessary in these circumstances and that it is too onerous, that the costs being requested are not warranted and that Mr. Smith does not want his name published in *CheckMark*. She advises that Mr. Smith has no issues with the recommended professional development courses, the reinvestigation or the reprimand.

28. With respect to the request for supervised practice, she submits that the precedent cases referred to by the Professional Conduct Committee all were more egregious than the case against Mr. Smith. She also refers us to several other decisions of the discipline committee under Rule 206 where supervised practice was not ordered including *Lui*, *McKechnie* and *Vroom*. With respect to the order for costs, she argues that costs of \$3,000 were more appropriate and that if supervised practice was ordered, the order for costs should be lower than \$3,000. With respect to the publicity in *CheckMark*, she argues that publication of Mr. Smith's name would be a huge blow to Mr. Smith given his high level of community involvement.

ORDER

29. After deliberation, the hearing reconvened and the chair summarized the order. The formal order was sent to the parties on February 10, 2005, and reads as follows:

IT IS ORDERED in respect of the charges:

1. THAT Mr. Smith be reprimanded in writing by the chair of the hearing.
2. THAT Mr. Smith be and he is hereby charged costs fixed at \$7,500, to be remitted to the Institute within twelve (12) months from the date this Decision and Order becomes final under the bylaws.
3. THAT Mr. Smith be and he is hereby required to complete, by paying for and attending in their entirety, by January 31, 2006, the following professional development courses made available through the Institute, or, in the event a course listed below becomes unavailable, the successor course which takes its place:
 - (a) *Accounting Refresher*;
 - (b) *Auditing Refresher*; and
 - (c) *Essentials of Review Engagements*.
4. THAT Mr. Smith be and he is hereby required to have his practice supervised for a period of twelve (12) months, by a supervisor who has been chosen by Mr. Smith but who is not a partner, associate or employee of Mr. Smith; who has been approved by either the director of standards enforcement or senior counsel to the professional conduct committee; and who has agreed in writing to accept the engagement. In particular:
 - (a) Mr. Smith shall, within thirty (30) days from the date this Decision and Order becomes final under the bylaws, file with the secretary of the discipline committee a supervised practice plan that has been reviewed and approved by either the director of standards enforcement or senior counsel to the professional conduct committee, and that sets out the name and the detailed responsibilities of the supervisor.
 - (b) The responsibilities of the supervisor shall include, at a minimum, the review and approval of all working papers and financial statements for all audit engagements.
 - (c) In the event the professional conduct committee finds Mr. Smith's choice of supervisor unacceptable, or there is any other issue relating to the supervised practice plan about which Mr. Smith and the professional conduct committee

cannot agree, either may apply to the chair of the panel or to the chair of the discipline committee at an assignment hearing for directions.

- (d) The twelve (12) month period of supervised practice shall commence on the day that Mr. Smith files the approved supervised practice plan in accordance with paragraph 4(a) above, or on the day the supervised practice plan is settled by the chair pursuant to paragraph 4(c) above, whichever day is later.
- 5. THAT Mr. Smith be reinvestigated by the professional conduct committee, or by a person retained by the professional conduct committee, on one occasion, within six (6) months from the expiry of the period of supervised practice ordered in paragraph 4, the cost of the reinvestigation, up to \$2,000, to be paid by Mr. Smith within thirty (30) days of receiving notification of the cost of the reinvestigation.
- 6. THAT notice of this Decision and Order, disclosing Mr. Smith's name, be given after this Decision and Order becomes final under the bylaws, in the form and manner determined by the Discipline Committee:
 - (a) to the Public Accountants Council for the Province of Ontario;
 - (b) to the Canadian Institute of Chartered Accountants; and
 - (c) by publication in *CheckMark*.
- 7. THAT in the event Mr. Smith fails to comply with any of the requirements of this Order, he shall thereupon be suspended from the rights and privileges of membership in the Institute until such time as he does comply, provided that he complies within three (3) months from the date of his suspension, and in the event he does not comply within this three (3) month period, he shall thereupon be expelled from membership in the Institute, and notice of his expulsion, disclosing his name, shall be given in the manner specified above, and in a newspaper distributed in the geographic area of Mr. Smith's current or former practice, employment and/or residence.

REASONS FOR THE ORDER

Reprimand

30. The panel is of the view that a reprimand is necessary as a specific deterrent to Mr. Smith, to stress to him the importance of maintaining the standards of the profession, and the unacceptability of his conduct as a chartered accountant. The panel would like to stress to Mr. Smith that it is imperative that he keep up to date on all areas of his practice – including accounting and auditing requirements – and not just on tax matters.

Professional Development Courses

31. The panel orders that Mr. Smith complete the following professional development courses by January 31, 2006 – Accounting Refresher, Auditing Refresher and Essentials of Review Engagements. In the panel's view, these courses will provide Mr. Smith with the technical skills and information to enable him to upgrade his accounting and audit skills to the level required of a chartered accountant. The panel encourages Mr. Smith to take as many of the courses as possible before his period of supervised practice commences.

Supervised Practice

32. The panel has decided that Mr. Smith's practice is deficient in both auditing standards and financial statement disclosure. As a result, we have determined that Mr. Smith would benefit from a defined period of supervised practice, and that this supervision is appropriate for the protection of the public.

33. The panel orders that Mr. Smith's audit practice be supervised for a period of 12 months. The panel thinks it is important for the period of supervised practice to be long enough to include one financial year-end for all of Mr. Smith's audit clients. The panel also determined that it is appropriate to require the filing of a supervised practice plan, and to have that plan approved. The plan is to clearly set out the duties of the supervisor, which shall include, as a minimum, the review and approval of Mr. Smith's working papers, financial statements, and reports prior to the issuance of the reports. In order to encourage Mr. Smith's speedy rehabilitation, we order that the supervised practice plan be filed within 30 days of our decision and order becoming final.

34. Our order also provides that in the event the Professional Conduct Committee finds Mr. Smith's choice of supervisor unacceptable, or there is any other issue relating to the supervised practice plan that Mr. Smith and the Professional Conduct Committee cannot agree upon, either of them may apply to the chair of the discipline committee for direction. The chair of the panel also commented on the record that, in the panel's view, it would not be appropriate for any of Mr. Smith's partners or anyone else in his firm to act as the supervisor.

Reinvestigation

35. In order to measure Mr. Smith's rehabilitation, the panel orders a reinvestigation of his practice within six months following the end of the period of supervised practice. Costs of the reinvestigation up to \$2,000 are to be paid by Mr. Smith.

36. The expectation of the discipline committee is that the reinvestigation will demonstrate that Mr. Smith's rehabilitation is complete. If the reinvestigation does not indicate that, Mr. Smith should not expect the discipline committee to base any subsequent sanction order on the principle of rehabilitation.

37. As set out in paragraph 16, Mr. Smith has advised the panel that he had made changes to his practice after the second reinspection by the Practice Inspection Committee. No explanation was given for the failure to take either the initial inspection or the first reinspection seriously enough to change his practice long before he did. The need to ensure that Mr. Smith complies with the standard of the profession, given his earlier failure to do so, in the view of the panel requires a reinvestigation.

Notice

38. The panel orders notice of its decision and order in the manner described above, including disclosure of the member's name. The notice provides both specific deterrence to the member and general deterrence to the membership at large. The panel agrees with the submissions of the Professional Conduct Committee that the facts in this case do not meet the test of rare and unusual circumstances for non-publication as requested by Mr. Smith.

Costs

38. The panel determined that it is appropriate for Mr. Smith to indemnify the Institute, in part, for the costs incurred. In this case, the panel orders that some of the costs incurred, on a partial indemnity basis, should be recovered from Mr. Smith. The panel concludes that Mr. Smith should be required to pay \$7,500 on account of the cost of this hearing and the related investigation.

Suspension/Expulsion For Failure To Comply

39. As with all orders of the discipline committee, this order provides for expulsion in the event that the member does not comply with the terms of the order. In this case, the panel determines that if Mr. Smith does not comply with the terms of the order, that he be suspended for three months. If he continues to not comply, he will be expelled and notice of his expulsion will be published in a newspaper distributed in the geographic area of Mr. Smith's current or former practice, employment and/or residence.

DATED AT TORONTO THIS 12TH DAY OF OCTOBER, 2005
BY ORDER OF THE DISCIPLINE COMMITTEE

M. BRIDGE, CA – CHAIR
DISCIPLINE COMMITTEE

MEMBERS OF THE PANEL:

D.L. FLEWELLING, CA
M.B. MARTENFELD, FCA
J.G. SEDGWICK, CA
P. McBURNEY (Public representative)