



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO

IN THE MATTER OF:

CHARGES AGAINST JOSEPH R. PILLO,
CA, A MEMBER OF THE INSTITUTE,
BEFORE THE DISCIPLINE COMMITTEE

JOSEPH R. PILLO

2011/04/16/25 20 11

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SETTLEMENT AGREEMENT

*made pursuant to Bylaw 510 (7.1) of the Bylaws of the
Institute of Chartered Accountants of Ontario*

Introduction

1. The Professional Conduct Committee approved draft charges against Joseph R. Pillo, CA ("Pillo") **Doc 1**.
2. The draft charges pertain to professional work performed by Pillo with respect to the audit of financial statements of "APC" for the year ended March 31, 2007 and the review of financial statements of "APM" for the year ended March 31, 2007.
3. The documents referred to in this agreement are found in the Document Brief. The applicable *CICA Handbook* sections are found in the Brief of Authorities.
4. The Professional Conduct Committee ("PCC") and Pillo agree with the facts and conclusions set out in this settlement agreement for the purpose of this proceeding only, and further agree that this agreement of facts and conclusions is without prejudice to Pillo in any other proceedings of any kind, including, but without limiting the generality of the foregoing, any civil or other

proceedings which may be brought by any other person, corporation, regulatory body or agency.

Background

5. Pillo obtained his CA in 1979, and practiced as a sole practitioner from 1979 through 1981. He moved to the firm DiLella, Pillo & Valenzano from 1982 through 1988, at which time Valenzano & Pillo LLP was formed.
6. Valenzano & Pillo LLP has two partners, two audit technicians, an accounting student, one administrative staff person and a part-time university student. The firm is approved for the training of CA students but currently employs none.
7. Pillo is the partner responsible for firm quality control and standards. He logged 53 structured PD hours in 2008 and 55 in 2009.
8. Pillo came to the attention of the PCC as a result of a complaint with respect to the conduct of the audit of "APC" and the review of "APM" for the year ended March 31, 2007. Both of these engagements are now in the hands of a successor accountant.

Charge 1 - The Audit of the Financial Statements of APC for the Year Ended March 31, 2007

9. The financial statements for APC for the year ended March 31, 2007 are reproduced at **Doc 2**.
10. Pillo issued the Auditor's Report attached to these financial statements and presented it and the financial statements to the shareholder of APC.
11. Materiality for this audit was set at \$134,318. **Doc 3, p. 70**

Charge 1(a) – Audit Strategy and Assessment of Risk of Material Misstatement

12. Although a checklist **Doc 3, p. 61** indicates that an audit planning checklist or memo was placed in the working paper file, there are no planning documents in the working papers other than materiality. An auditor is required to document the overall audit strategy and the audit plan. *CICA Handbook* 5150.22 **Tab 1**

13. The working papers do not include documentation of reports, analyses, or records of discussion with management which are required of the auditor in order that the entity, its environment, and the risks of material misstatement are clearly identified and understood. *CICA Handbook* 5141.123 **Tab 2**

14. *CICA Handbook* Section 5142.20 and .24 both stipulate that an auditor should request that management address misstatements and written representations from management should be obtained. **Tab 3**. The working paper file contains a summary of unadjusted differences ("SUDS") and there is no documentation of discussions with management regarding these differences. **Doc 3, pp. 70-71**

15. Although the SUDS exceed the materiality threshold determined, there is no documentation of discussion to assess whether the financial statements could be materially misstated as required by *CICA Handbook* 5145.04. **Tab 4**

Charge 1(b) – Engagement Letter

16. *CICA Handbook* Section 5110 **Tab 5** provides for required disclosures in an engagement letter, which include setting out the auditor's and management responsibilities. The engagement letter for this audit **Doc 4** does not include these required disclosures.

Charge 1(c) – Testing of Journal Entries

17. Auditors are responsible for obtaining an understanding of the controls over journal entries and to select entries for testing, in accordance with CICA Handbook Section 5135.077. **Tab 6**

18. When considering fraud, the auditor is responsible for reviewing the journal entries made, assessing controls and making inquiries of management.

19. Although a checklist **Doc 3, p. 61** was completed and signed off by the reviewer, there is no indication in the working papers that the journal entries were reviewed.

Charge 1(d) – Nature, Timing and Extent of Procedures

20. Information that comes to the auditor's attention as a result of performing audit procedures that differs significantly from information on which the audit plan was based may cause the auditor to modify the nature, timing and extent of the procedures. *CICA Handbook* 5142.11 **Tab 7**

21. There is no indication that Pillo revised materiality at the completion of the audit to ensure the appropriateness of the final materiality level. There appears to be no documentation to discuss the basis of assessing materiality, nor documentation to suggest that the materiality or summary of unadjusted differences ("SUDS") has been reviewed. **Doc 21, pp. 70-71**

Charge 1(e) – Disclosure of Guarantee

22. APC provided a corporate guarantee in the amount of \$1,000,000 to HSBC Bank of Canada, guaranteeing the credit facility of a related party, APM. **Doc 8 pp. 137-138**

23. This corporate guarantee is not disclosed in the financial statements of APC.

CICA Handbook AcG-14.9 **Tab 8**

Charge 1(f) – Disclosure of Significant Terms & Conditions

24. *CICA Handbook* Section 3860.52 **Tab 9** requires that the extent and nature of financial instruments be disclosed. Pillo did not disclose the significant terms and conditions for repayment, including interest rate, security provided or facility amount for the balance sheet item "Bank Indebtedness \$1,589,374".

Charge 1(g) – Disclosure of Financial Assets Pledged as Collateral

25. Although the balance sheet indicates "Bank Indebtedness \$1,589,374" there is no disclosure of the carrying value of the financial assets pledged as collateral for this balance sheet item **Doc 2** as required by *CICA Handbook* Section 3862.14. **Tab 10**

Charge 1(h) – Accounts Receivable

26. *CICA Handbook* Section 5145.11 **Tab 11** states that the auditor should document procedures performed, evidence obtained and conclusions reached with respect to relevant financial statement assertions and documentation should clearly demonstrate that the work was performed.

27. The audit working papers do not include documentation of work done to support the assessment of the allowance for doubtful accounts, the value of which was set at \$167,494 in 2007 and 2006. There is no documentation to explain the allowance, and no indication which accounts make up the allowance. **Doc 3, pp. 85-93**

28. There is no documentation in the working papers to show that the allowance for doubtful accounts had been discussed with the client.

Charge 1(i) – Disclosure of Income Taxes

29. Current income tax liabilities and assets are not presented separately from future income tax liabilities and assets as required by the CICA Handbook Section 3465.86. **Doc 3, pp. 101A-101B; Tab 12**
30. *CICA Handbook* Section 3465.87 **Tab 12** requires that current and non-current portions of future income tax liabilities and assets should be segregated. In this case, the member did not disclose non-current future tax balances as long-term. **Doc 3, pp. 101A-101B**

Charge 1(j) – Related Party Transaction

31. In the financial statements, Note 2 "LOANS RECEIVABLE" does not disclose that the loan in the amount of \$8,109,876 receivable from A. C. [REDACTED] & Sons [REDACTED], APC's parent company, is a related party transaction. This loan represents a significant portion of the total assets of APC of \$10,118,767, yet no balances were confirmed. **Doc 3, pp. 94-95** Although the working papers indicate that confirmations of the balances were sent, no confirmations are in the file and there is no indication of alternative procedures performed.
32. When auditing related party transactions, an auditor may wish to confirm the carrying amount and the basis for its determination. If confirmation would not provide reliable evidence, alternative procedures are to be performed to obtain evidence with respect to the balances. (*CICA Handbook* 6010.25) **Tab 13**

Charge 1(k) – Material GST Difference

33. A schedule was prepared for GST reasonability which notes an approximate difference of \$293,665, which was left unresolved. **Doc 3, p. 101** The value of the difference is significantly greater than materiality, which was set at \$134,138 for this audit.
34. There is no note in the working papers with respect to the GST difference or attempt to explain same. The working papers do not include any notes of discussions with the client in respect of the GST difference, and the lead sheet is documented as outstanding and appears not to have been signed off by the file preparer or by Pillo. **Doc 14 pp. 71, 101 CICA Handbook** Section 5300.07, 5300.18, and 5300.20 **Tab 14**

Charge 1(l) – Differential Reporting

35. The auditor's report and Note 1 to the financial statements make reference to differential reporting options. **Doc 2, pp. 29, 35-37** Note 6 to the financial statements indicates that APC has one issued common share valued at \$1. The differential reporting options as applicable to shares issued do not apply in this circumstance. *CICA Handbook* 3240.02 and 3240.13. **Tab 15**

Charge 1(m) – Management Representation Letter

36. Within the letter of representation **Doc 5**, there is no indication of management's responsibility for fair presentation of the financial statements or that they are presented in accordance with GAAP as required by *CICA Handbook* Section 5370. **Tab 16**

Charge 1(n) – Documentation

37. Items important to support the Auditor's Report are not adequately documented, including:

- a. There is no documentation in the file on the assessment of engagement risk as required by *CICA Handbook* Section 5141.007.
Tab 17
- b. There is no evidence of obtaining an understanding of internal controls as required by *CICA Handbook* Section 5141.013. **Tab 17**
- c. There is no documentation of team planning meetings as required by *CICA Handbook* Section 5141.014. **Tab 17**
- d. There is no evidence of discussions with management and those charged with governance as required by *CICA Handbook* Section 5150.27. **Tab18**
- e. Financial ratios have been prepared **Doc 3A** but there is no discussion on the impact of variances, or their review as required by *CICA Handbook* Section 5301.07. **Tab 19**
- f. There is no documentation on the basis of selecting confirmations, summary of differences, or overall appropriateness of the accounts receivable balances as required by *CICA Handbook* Section 5145.
Tab 20
- g. An account receivable is indicated as being in court, **Doc 14 p. 92** but there is no information on the status of litigation in the file. A legal letter was sent, but no response is included in the file.
- h. Many checklists are signed off by the preparer and by Pillo, but there is no indication of actual audit procedures performed as required by *CICA Handbook* Section 5145. **Tab 20**

Charge 2- The Review of the Financial Statements of APM for the Year Ended March 31, 2007

38. The financial statements for APM for the year ended March 31, 2007 are reproduced at **Doc 7**.
39. Pillo issued the Review Engagement Report attached to these financial statements and presented it and the financial statements to the shareholders of APM.
40. Materiality for this review engagement was set at \$128,072. **Doc 8, p. 110**

Charge 2(a) – GST Adjustment

41. The working papers do not contain documentation of a review of materiality toward the end of the engagement as a result of file changes, which were material. There is no overall conclusion on unadjusted amounts in the file (SUDS). The working papers indicate that an adjustment was to be recorded for GST however it was not booked. **Doc 8, p. 111** The value of the adjustment as determined by a CRA audit was \$170,615, which exceeded materiality which was set at \$128,072 for this year end.

Charge 2(b) – Accounts Receivable

42. Although accounts receivable confirmations were prepared, none were returned. There is no evidence in the working papers documenting follow-up on these confirmations. **Doc 8, pp. 115-118**
43. The allowance for doubtful accounts of \$23,852 did not change from the prior year. **Doc 8, p. 115** There was no documentation in the file of any procedures performed on these balances and no documentation that the

allowance was discussed with management, which are required under *CICA Handbook* Sections 8100.23 and 3840.50. **Tab 21**

Charge 2(c) – Inventory

44. The balance sheet item "Inventory 540,000" had materially increased from the prior year's inventory value of \$380,000. **Doc 8, p. 118A** There is no documentation of procedures followed to support and explain the increase in the working papers, as required under *CICA Handbook* Section 8100.23. **Tab 21**

Charge 2(d) –Capital Leases

45. *CICA Handbook* Section 3065.20 through .28 sets out proper disclosures related to capital leases. **Tab 22** They include the requirement to separate capital leases from other capital assets, the requirement to set out lease obligations with respect to capital leases and disclose those separately from financing leases, the requirement to separately disclose the gross amount of assets under capital lease and the related amortization, and the separate disclosure of amortization expenses related to capital assets.

46. In this instance, capital assets set out in Note 2 to the financial statements include equipment under capital leases, but the financial statements do not contain the documentation and disclosure required by the handbook. Similarly, Note 5 "Long term debt" does not properly disclose the capital lease obligations. **Doc 7, pp. 122, 124-130**

47. The "Statement of Loss" does not disclose the amount of amortization for equipment under capital leases. **Doc 7, pp. 49, 55**

48. The Statement of Cash Flows does not disclose the capital leases separately as financing activities as required by *CICA Handbook* Section 1540.19(e) **Tab 23**

Charge 2(h)(i) – Bank Indebtedness

49. The balance sheet item "Bank indebtedness 1,027,631" indicates a credit facility from HSBC Bank **Doc 7, p. 47; Doc 8, pp. 112-114, 137-138** however the extent and nature of the financial instrument is not disclosed as required by CICA Handbook Section 3860.52. **Tab 24**

50. The credit facility is not classified as a financing activity in the Statement of Cash Flows **Doc 7, pp. 51-54** as required by *CICA Handbook* Section 1540.10. **Tab 25** The financial statements provide no indication of the interest rate, the facility total, the repayment details or security for the credit facility as required by *CICA Handbook* Section 3860.54. **Tab 24**

Charge 2(j) – GST Discrepancy

51. The working papers include a schedule for GST reasonability, which shows a GST difference of \$189,537.27. **Doc 8, p. 132** The amount is greater than materiality, however there is no documentation of discussions with management, or any conclusion with respect to the amount, as required by *CICA Handbook* Section 8100.23. **Tab 21**

Charge 2(k) – Future Income Tax Asset

52. The working paper BB10 **Doc 8, pp. 134-135** indicates that a future income tax asset of \$226,807 was calculated. This future income tax asset is not otherwise reflected in the working paper file or in the financial statements. No corresponding future income tax liability was booked, and there are no notes of discussion with management with respect to these amounts.

53. *CICA Handbook* Section 3465.24 requires that at each balance sheet date, a future income tax asset should be recognized for all deductible temporary

differences, unused tax losses and income tax reductions. The amount recognized should be limited to an amount that is more likely than not to be realized. **Tab 26**

Charge 2(l) – Management Approval of Journal Entries

54. The adjusting entries working paper includes adjusting entries which exceed materiality, including one in the amount of \$3,320,000. **Doc 8, p. 109** There is no documentation on the file to support that the adjusting and unadjusted journal entries have been approved by management, or that they were reviewed by management.

55. There is no engagement letter in the file, and the adjusting journal entries were not attached to the management's letter of representation.

56. The working paper file does not include a planning memo, yet the file preparer has signed off that one was prepared. **Doc 8, p. 106 C/CA Handbook Section 8100.24 Tab 21**

Charge 2(m) – Related Party Transactions

57. The loan receivable from A [REDACTED] P [REDACTED] C [REDACTED] set out in Note 3, and the loan payable to A. C [REDACTED] & Sons [REDACTED] set out in Note 4, are not disclosed as related party transactions. **Doc 7, p. 53** The relationships between APM and these two entities is illustrated in the organizational chart at **Doc 10**.

58. *CICA Handbook* Section 3840.46 requires that where there is a related party transaction, disclosure must include a description of the relationship, a description of the transaction, the measurement basis, the amounts due to and from and conditions, contractual obligations and contingencies. **Tab 27** Pillo did not disclose the relationship between the parties or the interest rates.

Charge 2(n) – Documentation

59. Matters required to support the Review Engagement Report are not adequately documented, including:

- a. There is no disclosure in the financial statements for financial instruments as required by *CICA Handbook* Section 3860.44. **Tab 28**
- b. An independence letter **Doc 9** is included in the year end file but is unsigned and there is no documentation to indicate that it was sent to the client as required by *CICA Handbook* Sections 5751.35 and 8200.69. **Tab 29**
- c. Working paper PI.3, Knowledge of Client's Business, **Doc 8 pp. 107-108** is signed and dated by the file preparer but there is no evidence of review by Pillo as the engagement partner contrary to *CICA Handbook* Section 5025.17. **Tab 30**
- d. The accounts receivable listing of \$636,805 **Doc 8 pp. 116-118** does not agree to the amount \$379,843 **Doc 7 p. 46** included in the financial statements as required by *CICA Handbook* Section 8100.35. **Tab 31**

Charges 3 & 4 – Objectivity

60. The in-house bookkeeper for APC did not prepare the corporate bank reconciliations. Pillo did the reconciliations and subsequently performed the audit of the financial statements of APC for the year ended March 31, 2007.

61. In addition, Pillo acknowledges that he treated APC and APM as having 100% common ownership although the ownership was not the same.

62. Pillo made an adjusting journal entry for APM with respect to a loan from APC related to a supervision fee in the amount of \$3,320,000, along with various other adjusting entries. **Doc 3, pp. 72-76; Doc 8, p. 109** There was no indication in the working papers that management was aware of or had approved these entries. The entries were not attached to the management representation letter. Although Pillo arrived at the \$3,320,000 figure, there is no support for the computation of that amount in the working papers.

Charge 5 – Due Care

63. Pillo acknowledges treating APC and APM as having 100% common ownership although the ownership was not in fact the same.
64. APC is owned by "AC & Sons", which in turn is owned by four shareholders each with a 25% interest in the company. One of the 25% shareholders in AC & Sons has 100% ownership of APM. **Doc 10** The owner of APM provided Pillo with instructions on behalf of both APM and APC.
65. For the year ended March 31, 2007, APM was showing a loss, while APC was showing a profit. Pillo made adjusting journal entries between APC and APM for the purpose of reducing income taxes despite the fact that APC and APM did not have identical ownership. **Doc 3, pp. 72-76; Doc 8, p. 109**

Acknowledgement

66. It is agreed that, with respect to the audit of the financial statements of APC for the year ended March 31, 2007, Pillo 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*, in the manner described above.
67. It is agreed that, with respect to the review of the financial statements of APM for the year ended March 31, 2007, Pillo 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*, in the manner described above.

68. It is agreed that, with respect to the audit of the financial statements of APC for the year ended March 31, 2007, and the review of the financial statements of APM for the year ended March 31, 2007, Pillo failed to remain free of any influence, interest or relationship which impaired his professional judgment or objectivity or which would be seen by a reasonable observer to impair his professional judgment or objectivity, in the manner described above.

69. It is agreed that, with respect to the audit of the financial statements of APC for the year ended March 31, 2007, and the review of the financial statements of APM for the year ended March 31, 2007, Pillo failed to perform his professional services with due care, in the manner described above.

Considerations Supporting Settlement

70. In addition to all of the circumstances described above, the Professional Conduct Committee took the following factors into consideration on entering into this Agreement:

- a. Pillo acknowledges the deficiencies in his audit standards of practice as set out above; and
- b. Pillo has been fully cooperative in the Professional Conduct Committee's investigation into his conduct.

Terms of Settlement

71. Pillo and the Professional Conduct Committee agree to the following Terms of Settlement:

- a) A payment by way of fine in the amount of \$10,000;
- b) Pillo will attend, within 24 months from the time the Discipline Committee accepts this Settlement Agreement, the following professional development courses offered by the Institute (or their successor courses):
 - *Staying Out of Trouble;*
 - *Audit of Simple Entities;*
 - *Accounting Refresher; and*
 - *Income Tax Refresher - Corporate*
- c) Pillo shall, within 30 days of the approval of this Settlement Agreement, enter into a Supervision Agreement approved by the Director of Standards Enforcement ("the Director") with a Supervisor approved by the Director from outside of Pillo's practice who will review all assurance engagements undertaken by Pillo for a period of 18 months after the Discipline Committee accepts this Settlement Agreement, with the 18 month supervisory period to commence with the first assurance engagement undertaken by Pillo following approval of the Settlement Agreement;
- d) The Professional Conduct Committee will re-investigate Pillo at the end of the period of supervised practice with the costs of the re-investigation, up to \$2,500, to be borne by Pillo;
- e) Notice of the terms of this Settlement is to be published in accordance with the provisions of Bylaw 575(2), including notice to be given to the CICA, the Public Accountants' Council and in *CheckMark* Magazine; and
- f) Pillo will be allowed 18 months from the time the Discipline Committee accepts this Settlement Agreement to pay the fine referred to herein.

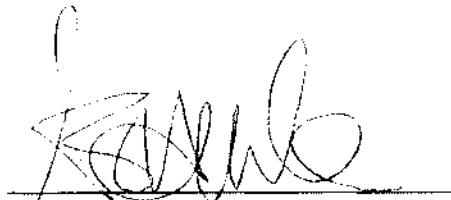
72. Should the Discipline Committee accept this Settlement Agreement, Pillo agrees to waive his right to a full hearing, judicial review or appeal of the matter subject to the Settlement Agreement. Upon the member fulfilling the requirements of this Settlement Agreement, the draft charges approved by the Professional Conduct Committee and dated February, 2010, shall be forever stayed.
73. If for any reason this Settlement Agreement is not approved by the Discipline Committee, then:
- a) This Settlement Agreement and its terms, including all Settlement Negotiations between the Professional Conduct Committee and Pillo leading up to its presentation to the Discipline Committee, shall be without prejudice to the Professional Conduct Committee and Pillo; and
 - b) The Professional Conduct Committee and Pillo shall be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing on the merits of the allegations set out in the charges, or negotiating a new Settlement Agreement, unaffected by this Settlement Agreement or the Settlement Negotiations.

Disclosure of Settlement Agreement

74. This Settlement Agreement and its terms will be treated as confidential by the Professional Conduct Committee and Pillo, until approved by the Discipline Committee, and forever if for any reason whatsoever this Settlement Agreement is not approved by the Discipline Committee, except with the written consent of the Professional Conduct Committee and Pillo, or, as may be required by law.

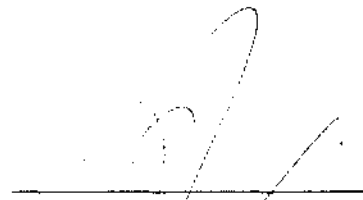
75. Any obligations of confidentiality shall terminate upon approval of the Settlement Agreement by the Discipline Committee.

All of which is agreed to for the purpose of this proceeding alone this 25th day of January 2011.



ALEXANDRA E. HERSAK
COUNSEL

On behalf of:
THE PROFESSIONAL CONDUCT COMMITTEE



JOSEPH R. PILLO, CA
on his own behalf