



THE PRACTITIONER'S VIEW

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AICA NEGOTIATES NO-COST DISCOVERY

POLICY FOR SOLE PRACTITIONERS

(The following article is reprinted from the AICA Newsletter *CARM* – May 2002)

AICA is pleased to announce that it has negotiated with the program's underwriters to provide a special no-cost discovery policy for sole practitioners to protect their retirements and their estates.

The new discovery policy is available to qualified sole practitioners upon retirement (or disablement, death, suspension or expulsion) at no premium cost. Issued annually, the policy provides coverage up to \$250,000 per claim or incident, subject to a \$500,000 annual aggregate limit. When you cease to practice, this policy protects you and your family should a claim result for work performed during your years in practice.

How a Discovery Policy Differs from your Current Policy

A discovery policy is one that covers prior acts and is an entirely different type of policy than your current professional liability insurance policy. Your current policy is issued on a "claims-made" basis; that is it only covers claims which the insured becomes aware of during the policy period. It does not cover claims which the CA becomes aware of subsequent to the expiration of the policy, even though the services may have been rendered while the policy was still in effect.

While a claims-made policy protects you when you renew it each year of your practice, the discovery policy protects your continuing risk exposure throughout your retirement and in the event of death, protects your estate and your family.

When You Retire, Your Professional Liability Doesn't

Many claims do not arise until years after the CA provided the service. The most frequent cases involve tax matters where a claim usually does not arise until the CCRA reassess the client. In recent years, the number of successful claims against the estates of deceased chartered accountants highlighted the need to make the

discovery policy a key part of every sole practitioner's estate planning.

Before You Retire, Talk to your AICA Program Representative

To qualify for the special discovery coverage, you must have been previously insured through AICA Services Inc. for a minimum of three years and have had no previously paid-for losses and no former firm coverage. If you currently have a Discovery Policy at the \$250,000 per claim limit with AICA, you may also qualify for this coverage if you meet the above criteria.

AICA will continue to issue the conventional discovery policy for those practitioners who have wound up their practice but wish to have excess coverage over the \$250,000 limit or for practitioners who do not qualify for a special Discovery Policy.

A CAUTIONARY TALE OF HST REMITTANCES

The May 2002 issue of *CARM*, published by AICA Services Inc., also includes an in-depth article on the accountant's liability for not reminding clients of their sales tax obligations.

The article states that the remittance of HST is increasingly giving rise to claim situations on review engagements. It goes on to stress the importance of performing analytical procedures to assess plausibility and discusses whether the engagement letter protects the accountant from liability.

Copies of this article may be obtained by contacting Wenda Bennett at the Institute. Practitioners may also wish to refer to a related article on assessing HST reasonableness in *The Practitioner's View* – January 2002. (Previous issues may be viewed on the ICANS website, under Publications)

IN THE WAKE OF ENRON...

the following topics are particularly relevant

FINANCIAL FRAUD

The following article is reprinted from ICAA Public Practice Bulletin – December 2001)

A speaker from the US Securities and Exchange Commission – Division of Enforcement made a presentation at the 4th CICA Annual Financial Reporting & Accounting Conference, a portion of which addressed financial fraud.

The following information relates to actual cases in which financial fraud had been identified in the investigative process conducted by this division. Although these

incidents were based in the USA, it would be logical to assume that similar situations may exist in Canada.

The most common schemes of financial fraud were categorized as follows:

1. Premature Revenue Recognition

The most common example of this is revenue from transactions culminated in subsequent periods being deliberately recorded as revenue in current periods to enhance current reporting results. Other examples of this are: backdating of contracts, fictitious invoices, shipment of unfinished product, characterization of consignment sales as final sales, revenue recognized on products not shipped or not yet manufactured, and hidden "side letters" giving customers rights to return a product.

2. Excess Reserves to Smooth Earnings

Entities, would, in periods of favourable results, make provisions to charge those periods with expenses; in subsequent periods of unfavourable results, management would reduce those reserves to artificially improve earnings ie: a smoothing effect. Examples where this could be done are: bad debt provisions, amortization provisions, warranty accrual estimates, etc.

3. Improper Capitalized Costs

Restructuring costs would be capitalized when they should have been expensed.

4. Changing Estimates "To Make the Numbers"

Deliberate manipulation of estimates to facilitate desired results.

Auditor Has a Responsibility

Although the primary responsibility for financial reporting rests with corporate management, auditors have professional guidelines, which outline their responsibilities regarding this area.

CICA Handbook Section 5135 – AUDITOR'S RESPONSIBILITY TO DETECT AND COMMUNICATE MISSTATEMENTS and 5136 – MISTATEMENTS – ILLEGAL ACTS clearly provide the auditor's responsibilities and procedures for auditors whom encounter financial fraud.

Proactive Action by Auditors

It is not uncommon to see the potential of financial fraud being addressed by prudent auditors in audit engagement files. The manner of documentation varies but may include self-developed checklists or memos in which the crucial areas of concern are covered or discussed. **It would be**

prudent for all auditors to address the potential existence of financial fraud on all audit engagements.

FILE RETENTION POLICY

Since Arthur Andersen, LLP has been found guilty of charges stemming from illegal destruction of documents relating to work performed for former client, Enron, firms may want to review their own document retention policies.

The Rules of Professional Conduct recommends that all client records be maintained for a minimum of 6 years, after which claims are statute barred, and on average 10 years (see Council Interpretations 218/2 and 218/3).

The 1999 practicing offices survey indicated the following results (48 respondents, of which 58% are sole practitioners):

Type of File	Average # of Years Files Are Retained		
	≤ 10	10 - 15	15 +
Working paper	5	6	37
Tax	4	8	36
Correspondence	4	9	35
Billing	6	8	34
F/S	5	6	37
Ex-clients	12	8	28

A surprisingly high number of respondents reported that they never disposed of old client records and files, even if they no longer have the client as an active account.

In order to assist public practice members in establishing a policy for working paper retention, members may consider the following suggested guidelines (these guidelines were proposed by the Alberta Institute for its members after reviewing those of other provincial institutes, publications dealing with the subject, and their 2001 public accounting firm survey):

1. It is important that a firm establish a policy with respect to working paper retention and follow through with the implementation of such a policy. From a legal perspective, it is important that a firm establishes that it has a retention policy and applies it to the practice.
2. Use common sense. There does not appear to be any file retention policy that is universally accepted. The underlying factor that determines the retention period is risk. The only way a member will be absolutely sure that all files are available if needed, is to retain them indefinitely. However, the high cost of storage dictates that permanent retention is not always practical.
3. Always require partner involvement whenever records are being destroyed. The guideline includes having the partner identify the client, the specific working papers, and overseeing the actual

destruction. Do not delegate the sole responsibility for file destruction to inexperienced staff.

- Files should be destroyed under supervision by shredding.

Members may wish to consult their legal advisors for assistance in formulating a policy.

(Note: Members are reminded that the guidelines in this article are suggestions only and are not an official pronouncement by either the Institute of Chartered Accountants of Nova Scotia or Alberta).

CICA NEWS - TWO CAmagazines

For those who missed it, the April 2002 issue of *CAmagazine* introduced their new web publication: **CAmagazine.com**. This online magazine offers articles and other types of information, such as links to sites of interest to CAs and other financial professionals, that **will not appear in the printed version** and a new, powerful search tool that makes all articles published by the magazine available on the internet since it first went online in 1995.

CAmagazine.com articles will be updated on a daily basis, and the site will provide late-breaking news and exclusive feature articles of interest to all CAs.

DIFFERENTIAL REPORTING

Optional provisions for financial reporting by Small Business Enterprises

The following article is reprinted from ICAA Regulation Update – May 2002)

INTRODUCTION

The issuance of *CICA Handbook* Section 1300, entitled **differential reporting** is a milestone event in Canadian professional accounting standard setting. The issue of Big GAAP (Generally Accepted Accounting Principles) and Little GAAP has been debated and discussed most likely ever since the issuance of the very first accounting standard. Differential reporting now introduces the application of Little GAAP, although only on a limited basis.

Differential reporting may only be applied effective for fiscal years beginning on or after January 1, 2002. Earlier adoption is not permitted!

MAJOR ASPECTS OF DIFFERENTIAL REPORTING

Restriction of Use

Differential reporting may only be applied when an entity (referred to as a “non-publicly accountable enterprise”) meets the following specific criteria:

- Entity is a profit-oriented enterprise
- No public accountability exists for the entity
- All owners**, including those not otherwise to vote, provide **their unanimous consent in writing**

- Owner’s consent must be given **prior to the date of completion of the respective financial statements**

Owners are the individuals and entities that have an ownership interest in an enterprise. Owners include sole proprietors of unincorporated businesses, voting and non-voting shareholders of corporations with share capital, and partners of partnerships.

Features of Differential Reporting are Available on a Selected Basis

Qualifying entities can select one or more of the specific technical differential reporting features. **It is not a requirement to select all seven options.**

Requirements to Meet When Exercising Options Within Differential Reporting

- There must be disclosed an accounting policy note stating:

- Differential Reporting has been adopted.
- Which specific features of differential reporting options have been selected.

See Appendix A for an illustrative example.

When an entity first applies one or more of the differential reporting options, the effect of the change in accounting policies should be applied retroactively per CICA Handbook Section 1506.

- There must be obtained written consent of all owners by either:

- Obtaining **each year** the written consent to the application of selected differential reporting options
- Include wording in the initial consent being obtained**, such that the consent remains in effect for subsequent years until rescinded by the owners.

Any change in either selected options or ownership will require a renewal of the consent of all owners.

- There must be a consistent application of a differential reporting option to similar items or transactions.

When a qualifying entity chooses to apply a differential reporting option, it must apply that option to all similar items or transactions. If an option is not selected, all of the requirements must be followed as stated for entities not qualifying for differential reporting.

- There must be a cessation of differential reporting options when an entity that qualified for differential reporting earlier no longer qualifies.

When an entity (that previously qualified for differential reporting) no longer qualifies, it should cease to apply all differential reporting options.

Any policy change is a change in an accounting policy and must be retroactively applied as per CICA Handbook Section 1506.

TECHNICAL OPTIONS OF DIFFERENTIAL REPORTING

There are seven options available pursuant to differential reporting. Areas impacted are:

Area	CICA Handbook Section
1. Subsidiaries	1590
2. Interim Financial Statements	1751
3. Long-term Investments	3050
4. Interests in Joint Ventures	3055
5. Share Capital	3240
6. Income Taxes	3465
7. Financial Instruments – Disclosure and Presentation	3860

Appendix B provides the detail of the financial reporting options of each area.

CONCLUSION

Members considering applying **differential reporting** are encouraged to read *CICA Handbook* Section 1300 for specific guidance.

NEW AUDIT STANDARDS CLARIFY AUDITOR'S RESPONSIBILITY TO DETECT FRAUD

In January, the Assurance Standards Board approved new *CICA Handbook – Assurance* Section 5135, *The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements*, and revisions to Section 5090, *Audit of Financial Statements – An Introduction*. The new standards will apply for December 31, 2002 year-end audits, which means that fiscal periods subject to the revised Recommendations have already started.

Accordingly, practitioners should ensure they promptly communicate the additional guidance to their audit staff. In particular, auditors, should familiarize themselves with the fraud risk factors, the example procedures responding to identified fraud risk, and the matters that may alert auditors to heightened fraud risk in Appendices A through C of Section 5135.

The March 2002 issue of Risk Alert, published by the CICA, is a special edition that highlights some of the key features of the new standards. This may be viewed on the CICA website under Standards & Guidance, Assurance Standards – Recently Issued.

AUDIT FILE BLOOPERS!

An article in the May 2002 issue of The Professional Engagement Manual contains some of the more humorous comments to come across the desk of a firm's quality assurance reviewer. They drive home the importance of

providing staff training on how to prepare appropriate documentation and conclusions for the working papers.

Definitely worth reading!

MINDING YOUR E-BUSINESS SEMINAR

Small business must learn how to manage e-security and privacy risks. That's the message of Minding Your E-business, a new seminar being offered by Canada's banking industry through the Canadian Bankers Association (CBA). It is intended to help businesses think about security and privacy issues from a business risk perspective, how to assess their level of risk and how to find the right solutions for their business. The seminar also examines legal and compliance matters and how to stay informed about emerging security and privacy issues.

Some issues to think about:

- All organizations involved in commercial activities must be privacy compliant by December 31, 2003.
- Businesses and organizations typically think virus damage can be repaired but often do not think about the financial loss associated with lost data, loss of privacy and loss of reputation with clients and consumers.
- Small businesses are a favorite target for hackers.
- 99% of intrusions result from the exploitation of known vulnerabilities or configuration errors where measures were available to prevent them.

The Minding Your E-Business seminar builds on the success of the CBA's Preparing Your Business for the E-Commerce Age seminar, which ran in 2000-2001. A chartered accountant with expertise in privacy and e-security delivers the free two-hour non-commercial seminar, which is designed specifically to meet the information needs of small and medium-sized businesses.

The CBA is spearheading this national initiative in co-operation with the Canadian Institute of Chartered Accountants (CICA), ICANS, the Canadian Chamber of Commerce and local Chambers, and Industry Canada. The CBA, on behalf of the banking industry, is underwriting all costs. A number of no-charge seminars will be held throughout Nova Scotia this fall and you and your clients are encouraged to attend. To learn more about the seminars and to obtain a list of upcoming seminar dates and locations, visit the e-business section on the CBA's web site www.cba.ca or contact Caroline Hubberstey at 1-800-263-0231 ext. 5.

SUGGESTIONS FOR THE NEXT ISSUE?

Contact **Wenda Bennett, CA** at the Institute wbennett@icans.ns.ca or (902) 425-3291.

APPENDIX A: EXAMPLE OF AN ACCOUNTING POLICY NOTE TO FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The company, with the unanimous consent of its shareholders, has elected to prepare its financial statements in accordance with Canadian generally accepted accounting principles, using the differential reporting options available to non-publicly accountable enterprises described below:

a) Income taxes*

The company has elected to apply the differential reporting measurement option allowed for income taxes and, accordingly, to account for income taxes using the taxes payable method.

(b) Financial instruments

The company has elected not to disclose fair value information about financial assets and liabilities for which fair value was not readily obtainable.

* **Note:** If this option is selected, further information disclosures are required as stated in Appendix B.

APPENDIX B: DETAIL OF THE TECHNICAL OPTIONS OF DIFFERENTIAL REPORTING

1. SUBSIDIARIES, SECTION 1590

An enterprise that qualifies under **differential reporting**, Section [1300](#), may elect to use either the equity method or the cost method to account for subsidiaries that would otherwise be consolidated. All subsidiaries should be accounted for using the same method.

A loss in value of an investment in a non-consolidated subsidiary that is other than a temporary decline should be accounted for in accordance with the requirements of **long-term investments**, paragraphs 3050.20 - [.26](#).

When an enterprise applies one of the alternative methods permitted by paragraph [1590.26](#), the financial statements should be described as being prepared on a non-consolidated basis and each statement should be labeled accordingly.

Investments in non-consolidated subsidiaries should be presented separately in the balance sheet. Income or loss from those investments should be presented separately in the income statement.

An enterprise that has applied one of the alternative methods permitted should disclose:

- a. the basis used to account for subsidiaries; and
- b. the particulars of any shares or other securities issued by the enterprise that are owned by non-consolidated

subsidiaries.

The requirements of **related party transactions**, Section 3840, apply to inter-company transactions that would otherwise have been eliminated on consolidation.

2. INTERIM FINANCIAL STATEMENTS, SECTION 1751

An enterprise that is not subject to a periodic interim reporting requirement may present, as comparative information, the income statement, the statement of retained earnings and the cash flow statement of the immediately **preceding year**.

3. LONG-TERM INVESTMENTS, SECTION 3050

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to use the cost method to account for its investments in companies subject to significant influence that would otherwise be accounted for by the equity method. All investments in companies subject to significant influences should be accounted for using the same method.

Investments in companies subject to significant influence accounted for using the cost method should be presented separately in the balance sheet. Income from those investments should be presented separately in the income statement.

An enterprise that has applied the alternative method should disclose the basis of accounting used to account for investments in companies subject to significant influence.

4. INTEREST IN JOINT VENTURES

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to use either the equity method or the cost method to account for its interests in joint ventures. All interests in joint ventures should be accounted for using the same method.

A loss in value of an interest in a joint venture not proportionately consolidated that is other than a temporary decline should be accounted for in accordance with the requirements of **long-term investments**, paragraphs 3050.20 - .26.

Interests in joint ventures not proportionately consolidated should be presented separately in the balance sheet. Income or loss from those interests should be presented separately in the income statement.

An enterprise that has applied one of the alternative methods should disclose the basis used to account for interests in joint ventures.

The requirements of **related party transactions**, Section 3840, apply to the inter-entity transactions that would otherwise have been eliminated to the extent of the ventures' interest.

5. SHARE CAPITAL, SECTION 3240

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to disclose the information required by paragraph 3240.02 only for classes of shares that have been issued.

6. INCOME TAXES, SECTION 3465

***Note:** The taxes payable basis is a method of accounting under which an enterprise reports as an expense (income) of the period only using the cost (benefit) of the current income taxes for the period, determined in accordance with the rules established by the taxation authorities.

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to account for income taxes on the taxes payable basis and thereby not report future income taxes otherwise recognized in accordance with this Section.

When an enterprise applies the alternative method, the financial statements should disclose the following:

- a. income tax expense (benefit) included in the determination of income or loss before discontinued operations and extraordinary items, (see **income statement**, Section 1520);
- b. income tax expense (benefit) related to discontinued operations;

- c. income tax expense (benefit) related to extraordinary items;
- d. a reconciliation of the income tax rate or expense related to income for the period before discontinued operations and extraordinary items to the statutory income tax rate or the dollar amount that would result from its application, including the nature and amount of each significant reconciling item;
- e. the amount and timing of capital gains reserves and similar reserves to be included in taxable income within five years;
- f. the amount and expiry date of unused tax losses carried forward and unused income tax credits; and
- g. the portion of income tax expense (benefit) related to capital transactions that is charged (or credited) to equity (see paragraphs 3465.72 and 3465.83).

7. FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION, SECTION 3860

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to present as equity preferred shares issued in tax planning arrangements under Sections 51, 85, 85.1, 86, 87, or 88 of the Income Tax Act when those shares would otherwise be presented as liabilities in accordance with paragraph 3860.18.

When an enterprise applies the alternative presentation for the preferred shares described therein, it should:

- a. present those shares at par, stated or assigned value as a separate line item in the equity section of the balance sheet, with a suitable description indicating that they are redeemable at the option of the holder;
- b. disclose on the face of the balance sheet the total redemption amount for all classes of such shares outstanding; and
- c. disclose:
 - i) the aggregate redemption amount for each class of such shares; and
 - ii) the aggregate amount of any scheduled redemptions required in each of the next five years.

An enterprise that qualifies under **differential reporting**, Section, 1300, may elect to disclose the information required by paragraph 3860.78 only for financial assets and financial liabilities, both recognized and unrecognized, for which fair value is readily obtainable.

An enterprise that qualifies under **differential reporting**, Section 1300, may elect to disclose the information required by paragraph 3860.89 only for those financial assets for which fair value is readily obtainable.

Fair value is readily obtainable for financial assets and financial liabilities that have a quoted market price, and for freestanding forward contracts, options and similar derivative instruments. Fair values may also be readily obtainable for other financial assets and liabilities.