



# THE PRACTITIONER'S VIEW

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## ACCOUNTING and AUDITING STANDARDS

Now that September is here, it's time to "gear up" for another busy season – PD, Practitioner's Forum, etc. To get the ball rolling, we'll look at some significant new standards and guidelines issued by CICA over the summer as well as some that came into effect for December 31, 2002 and later fiscal year-ends.

### NEW RELEASES

#### Reports on Financial Statements Prepared on a Basis of Accounting Other than GAAP

For audit and review engagement reports issued after October 1, 2003, public accountants engaged to report on financial statements prepared using a basis of accounting other than GAAP may seek guidance in recent amendments to *Auditor's Report on Financial Statements Prepared Using a Basis of Accounting Other Than Generally Accepted Accounting Principles*, Section 5600, *General Review Standards*, Section 8100 and *Public Accountant's Review of Financial Statements*, Section 8200. The new requirements apply only when such statements are prepared:

- (a) in accordance with regulatory or legislative requirements to meet the specific needs of a regulator or a legislator; or
- (b) in accordance with written contractual requirements such as may be set out in trust indentures or buy/sell agreements.

This new section was developed to create a consistent approach to the wording of the auditor's report when GAAP is not applied. Until now, guidance in the CICA Handbook – Assurance dealt with this issue on an ad hoc basis. As a result, different reporting styles emerged, including "soft qualifications", such as ones referring to "GAAP other than...".

Highlights of the new section require the public accountant to:

- *confirm in writing* the understanding reached with the entity as to the intended purpose of the financial statements and the basis of accounting to be used.
- consider whether disclosures in the notes to the financial statements appropriately describe:
  - (a) the purpose(s) of the financial statements;
  - (b) the basis of accounting used in preparing the financial statements including the material differences between the basis of accounting and GAAP, which need not be quantified.

- Include in the auditor's report:
  - (a) the purpose(s) for which the financial statements have been prepared: and
  - (b) in a paragraph after the negative assurance paragraph,
    - that the financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian GAAP, are solely for the information and use of the addressee, the regulator or legislator, or the parties to the contract, for the purpose(s);
    - and the financial statements are not intended to be used by anyone other than the specified parties or for any other purpose.

The Appendix to Section 5600 includes 4 sample reports; of particular interest is Example D – *Auditor's report on financial statements of a housing co-operative filed with Canada Mortgage & Housing*.

#### Generally Accepted Accounting Principles – Handbook Section 1100

This new section, effective for fiscal years beginning on or after October 1, 2003 establishes standards for financial reporting in accordance with GAAP. It describes what constitutes Canadian GAAP and its sources, replacing Financial Statement Concepts, paragraphs 1100.59 -.61.

Highlights of this section particularly worth noting are:

- if the basis of accounting used to prepare financial statements in accordance with regulatory, legislative or contractual requirements conflicts with the requirements of the Section, that basis cannot be described as being in accordance with GAAP.
- clarifies that Accounting Recommendations and non-italicized paragraphs have equal authority.
- Identifies some of the other sources that an entity might consult in selecting accounting policies and disclosures when not dealt with explicitly in the primary sources of GAAP.

### RECENT RELEASES

The following standards were reviewed in an article that appeared in the May 2003 issue of "News 'n Views", a publication of the Institute of Chartered Accountants of BC and is reprinted with the permission of ICABC.

#### Non-Consolidated Financial Statements

What happens when your client prepares non-consolidated financial statements but does not qualify for Differential Reporting? With the introduction of Differential Reporting, the previous "soft qualification" for non-consolidated financial statements has been withdrawn. Consequently the audit or review engagement report will fall under Handbook Section 5500 - Reservations in the Auditor's Report.

By not preparing consolidated financial statements, it is likely that *virtually every account in, and the information provided by way of notes to the financial statements will be materially*

*different*. Thus, the appropriate reservation would likely be an adverse opinion [see example in Handbook Section 5510.G], unless the non-consolidated subsidiary is sufficiently simple that the effects of non-consolidation can be set out in the report or a note to the financial statements.

#### **Differential Reporting – Handbook Section 1300**

For fiscal years beginning on or after January 1, 2002, clients are able to “opt out” of certain sections of the CICA Handbook. Some important considerations relating to implementing Differential Reporting include:

- Early adoption of the section is not allowed.
- The section does not apply to Non-Profit Organizations.
- The adoption of the specific reporting options chosen by the client needs to be agreed to by all of the owners of the enterprise, in writing, prior to the date of the completion of the financial statements. In the case of a corporation, you will require the consent of both voting and nonvoting shareholders.

Members should think through recommending that their clients adopt differential reporting as in some cases the disclosure and other requirements of Section 1300 are greater than they otherwise would be. You should also remember that significant changes to your audit or review engagement report, the accounting policy notes, the letter of representation and the engagement letter are required if your client adopts any of the differential reporting options.

#### **Property, Plant & Equipment – Handbook Section 3061**

The significant change introduced in this section is the terminology used to describe what was previously known as “Capital Assets”. Given the introduction of Section 3062—Goodwill and Other Intangible Assets, the term “Capital Assets” includes goodwill and intangibles. As a result, depreciable tangible assets will have to be described as “Property, Plant & Equipment”, “Plant & Equipment” or some other descriptive name. This change does not apply to not-for-profit organizations, which should comply with Handbook Section 4430.

#### **Goodwill and Other Intangible Assets - Handbook Section 3062**

For fiscal years beginning on or after January 1, 2002, goodwill and intangible assets are no longer permitted to be amortized. Instead, the value of these assets has to be tested for impairment on a regular basis (at least annually), unless the entity qualifies for Differential Reporting - see Section 3062.55. For assurance engagements, this will in most cases require a separate valuation of the assets concerned. You will need to carefully consider your level of involvement in determining asset valuations and whether that has an impact on your independence.

Also, “goodwill” and “other intangible assets” now require separate line item disclosure. They should not be grouped as “Goodwill and other Intangibles” as has commonly been done in the past.

#### **Auditors Responsibility to Consider Fraud & Error - Handbook Section 6135**

For fiscal years ending on or after December 15, 2002, the auditor must now specifically address the risk of material misstatements resulting from fraud and error. Auditors must do so when planning the audit, take it into account when designing audit procedures, and document the fraud and risk factors identified during planning and their responses (such as mitigating controls or changes to planned audit procedures).

Members should remember that the **representation letter received from management should be amended** to include the following items:

- Acknowledgement of its responsibility for the implementation and operation of internal controls that are designed to prevent fraud and error.
- The belief that the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation.
- Acknowledgement that they have disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity.
- Have disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

These are just some of the many new standards, or changes to old ones, that have been made within the last 6 to 12 months. We have found that members are failing to remain current as a result of the increased reliance on electronic versions of various resource materials and the speed at which new pronouncements are being made. You are urged to take the time necessary to make yourselves familiar with new pronouncements as they are made.

## **PRACTICE MATTERS**

#### **ANTI-MONEY LAUNDERING REQUIREMENTS**

The following article appeared in the May 2003 issue of “*News ‘n Views*”, a publication of the Institute of Chartered Accountants of BC and is reprinted with the permission of ICABC.

Members, do you do any of the following for your clients:

1. Receive or pay funds?
2. Purchase or sell securities, real property or business assets or entities?
3. Transfer funds or securities by any means?
4. Give instructions on behalf of any person or entity in respect of any of the above 3 activities?
5. Receive professional fees in respect of the 3 activities named or in respect of any instructions referred to above?
6. Send currency or monetary instruments across the border?

If you do, you have certain responsibilities under Canada's anti-money laundering legislation.

The Financial Transactions and Report Analysis Centre of Canada (FINTRAC) is the body responsible for ensuring compliance with the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (the Act). Members need to be aware of how this legislation can affect them.

## **Implications for Audit, Review, and Compilation Engagements**

Members providing audit, review, and compilation engagement services do not have any statutory responsibility to report under the Act. However, should you encounter circumstances that suggest money-laundering activities, you should be aware of the increased risk of misstatement in the financial statements and other forms of fraud. Most of all, you need to consider the effect on your reputation and other possible legal consequence. If in doubt, seek legal advice.

Be sure to review CICA Handbook Section 5136 Misstatements - Illegal Acts if you encounter such unusual circumstances during an audit. If you are performing a review, consider whether there are now doubts as to the plausibility of the financial information and consider performing additional procedures as suggested for an audit. If you are performing a compilation and the circumstances lead you believe that the financial statements are false or misleading, you should request additional or revised information. If that is not forthcoming, consider not releasing the statements and resigning from the engagement.

### **Cross-border Transfers of Currency**

There are two parts to the legislation. One part of the Act deals with the transfer of currency or monetary instruments across borders and it applies to EVERYONE. When someone sends cash or monetary instruments over \$10,000 across the Canadian border, the person or entity must complete a Currency and Monetary Instrument Reporting form for CCRA who then sends a copy to FINTRAC.

### **Financial Intermediaries**

The other part of the Act deals with record keeping and reporting of suspicious transactions and prescribed financial transactions. This section DOES NOT apply to CAs engaged in the performance of audits, reviews, or compilations carried out in accordance with the recommendations set out in the C1CA Handbook. It DOES apply if the CA has been engaged to act as a financial intermediary, namely activities numbered 1 to 5 listed above.

### **Compliance Regime**

If members are acting as financial intermediaries, then they must implement a compliance regime covering the recording and reporting of suspicious transactions and prescribed financial transactions, as well as reporting cross-border transfers of currency or monetary instruments at or above a specified threshold (more on these transactions below). This regime also includes, as far as practicable, the following:

- Obtaining a commitment from senior management (partners in the case of CA firms).
- Appointing compliance officer.
- Developing compliance policies and procedures.
- Monitoring the effectiveness of the compliance system.
- Providing ongoing training for employees and agents.

Members should be aware that FINTRAC has the power to enter the premises of a financial intermediary without a search warrant, to determine whether they are complying with their obligations to report and record transactions.

## **Suspicious and Prescribed Transactions**

Where members are acting as financial intermediaries, members must report to FINTRAC any transactions where there are reasonable grounds to suspect the transactions are related to the commission of a money laundering offence or a terrorist activity financing offence. Members must use their professional judgment, as there is no ready definition of what constitutes a suspicious transaction. However, they can look to Guidelines from FINTRAC for guidance in assessing whether a transaction is suspicious and should be reported.

When acting as financial intermediaries, members must keep large a cash transaction record, unless the cash is received from a financial entity or a public body. In addition, members must:

- Ascertain the identity of the person involved in the transaction.
- Take reasonable measures to determine whether the individual who gives the cash is acting on behalf of a third party.
- Obtain and retain a third party disclosure statement signed by the client if they are acting on behalf of a third party, or if there are reasonable grounds to conclude this is the case.

Starting January 31, 2003, members acting as financial intermediaries must reporting the following transactions:

- Large cash transactions involving amounts of \$10,000 or more.
- Sending or receiving of international electronic funds transfers of \$10,000 or more.
- Foreign exchange transactions at a rate that exceeds the posted rate, and the payment by an individual of transaction fees that exceed the posted

### **Members' Responsibilities**

Members are reminded that the requirements for implementing a compliance regime and the reporting of suspicious transactions and prescribed financial transactions are required only if you are providing services deemed to be that of a financial intermediary. Failure to comply with the Act can result in serious penalties: five years imprisonment and/or a fine of \$2 million. To help members understand their responsibilities under the legislation, CICA has developed *Canada's Anti-Money Laundering Requirements: A Guide for Chartered Accountants*, which is available on their website at [http://www.cica.ca/index.cfm/ci\\_id/8238/la\\_id/1.htm](http://www.cica.ca/index.cfm/ci_id/8238/la_id/1.htm).

In addition, FINTRAC has produced a series of Guidelines to help accountants comply with their responsibilities under the Act. Please visit their website and download the documents: [http://www.fintrac.gc.ca/publications/guide/guide\\_e.asp](http://www.fintrac.gc.ca/publications/guide/guide_e.asp).

Members are urged to review carefully the range of services they provided to their clients. If you are acting as financial intermediaries, then you should consider developing a communications strategy to disclose, in writing, your reporting obligations and other requirements under the Act. This is something you need to discuss with your clients because the statutory requirement for financial intermediaries to report suspicious transactions overrides our Rules of Professional Conduct with respect to client confidentiality.

## NEW GOVERNANCE PUBLICATIONS – 20 QUESTIONS SERIES

Canada's Chartered Accountants are helping directors tackle such controversial areas as executive compensation, risk, and Management's Discussion and Analysis (MD&A) with the release of five new titles in the '20 Questions' series of booklets.

The new books, co-sponsored by the Institute of Corporate Directors, arm directors with the thinking behind key questions they should be asking to meet their responsibilities to shareholders and management.

Titles include:

- 20 Questions Directors Should Ask About Executive Compensation
- 20 Questions Directors Should Ask About Risk
- 20 Questions Directors Should Ask About Management's Discussion and Analysis
- 20 Questions Directors Should Ask About Strategy and Strategic Planning: What Boards Should Expect from CFOs
- 20 Questions Directors Should Ask About Privacy
- 20 Questions A Small Business Should Ask About Privacy and Canada's Privacy Legislation – What It Means For Your Organization

For more information on the 20 Questions series check out the CICA website at [www.cica.ca](http://www.cica.ca).

## PRACTICE DEVELOPMENT

### GOOD COMMUNICATION - HOW TO BE CAREFUL AND STILL BE CLEAR

Balancing the accountant's need for protection with the client's need for clarity was the focus of an article in the *Journal of Accountancy*, January 2001.

It noted that the scope of an engagement seems to be a common area for misunderstanding. Of course, to guard against lawsuits, engagement letters should always be obtained and where possible, use the standard disclaimers recommended by the profession.

However, other documents such as proposals, correspondence and management letters have more flexibility with wording. Fortunately, the types of documents that are least affected by professional standards are those that are most important for practice development.

Three common haze makers you can eliminate are:

- (1) Waffle words

These words (also known as weasel words) - such as *seems*, *indicates*, *appears* - are used to soften direct statements but offer little protection from a legal standpoint.

Instead, write what you mean. For example, if there are discrepancies, then don't write *there seem to be discrepancies*.

- 2) Long, involved sentences

Unlike Charles Dickens, you aren't paid by the word, so keep your average sentence length between 10 and 17 words. Use bullet points if that will make the information easier to grasp.

Have no more than five lines per paragraph, and try to place no more than 11 numbers on a page.

Cut long sentences at conjunctions (*and*). Group related information. Reduce the average length of your sentences. Use the active voice as much as possible.

- 3) Convoluted disclaimers

One purpose of a disclaimer is to educate the client about the extent and type of service that will be rendered. Practitioners should ask themselves if a jury would understand the disclaimer they've written; if not, then reduce and clarify it. Also, rather than rely exclusively on a written disclaimer, meet with the client and tell them what's involved in the engagement.

### Words to the Wise

Problem	Solution
The effect comes before the cause <ul style="list-style-type: none"><li>▪ B is caused by A</li></ul>	Transpose the cause and effect <ul style="list-style-type: none"><li>▪ A caused B</li></ul>
Using nouns instead of verbs <ul style="list-style-type: none"><li>▪ X stated that payment would not be made</li></ul>	Use the verb form <ul style="list-style-type: none"><li>▪ X stated that they would not pay</li></ul>
Using the passive voice <ul style="list-style-type: none"><li>▪ The amounts are expected to be collected</li></ul>	Use the active voice <ul style="list-style-type: none"><li>▪ The company expects to collect the amounts</li></ul>

The article concludes that a vital way to build strong client relationships is through frequent, clear communication, both spoken and written. In today's highly competitive economy, it's hard to maintain a significant market advantage based on technical skills alone. For many businesses, the most powerful value-added service is communication.

## PRACTITIONER'S FORUM/GOLF DAY

Don't forget to register **by September 25<sup>th</sup>** for the Annual Practitioner's Golf Day, to be held Tuesday, October 2<sup>nd</sup> in Truro. A registration form is enclosed.

The Annual Practitioner's Forum, scheduled for October 30<sup>th</sup> will also be held in Truro. New independence standards, CCRA developments and planning for sudden death or incapacity are some of the topics sure to generate interest!

## SUGGESTIONS FOR THE NEXT ISSUE?

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