



# THE PRACTITIONER'S VIEW

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## INDEPENDENCE ED SESSION

Don Wray, FCA, Chair of the CICA Public Interest & Integrity Committee, met with Bob Caswill, Sheila Gillis and over 35 CAs on November 25th to discuss the new Independence Exposure Draft, issued for comment in September.

Members in attendance expressed their concern over the complexity of the ED and the possible impact that it would have on their ability to continue to serve the needs of their clients in an effective manner, particularly in the area of review engagements. Particular concern was expressed that the restrictions placed on publicly-listed entity engagements would be applied to a broader than intended range of clients, including MUSH and other non-public entities with active audit committees, or mandated by financial institutions and other lenders.

D. Wray agreed to take this feedback to the upcoming PIIC meeting, and assured attendees that the committee would take steps to clarify the draft and ensure that inadvertent negative impacts would be addressed.

Attendees were advised that a further draft would need to be released sufficiently in advance of the June 2003 Annual Meetings of the PICAs if it was intended that any changes would be adopted by member vote at that time. S. Gillis and the Executive Director committed that ICANS members would be provided with sufficient communication prior to any Council decision to take the matter to the annual meeting through a combination of written material, further information sessions, and the formation of a working group of interested practitioners to review the revised draft and its impact on practice in Nova Scotia.

## PRACTITIONER'S FORUM

The 2002 Practitioners Forum was a particular success this year, with the highest attendance to date. This annual event is an opportunity for members with common interests to meet each year to participate in a number of sessions selected specifically to be of interest to the attendees, as well as offering a strong networking opportunity.

Evaluations of this year's event resulted in 97% of all respondents reporting that the forum met their

expectations, and 100% of those responding would recommend this forum to their peers.

Particular interest was expressed in the sessions dealing with retirement and succession strategies, which may lead to additional sessions focussing on this area. Building on the success of this service to the members, ICANS will be considering expanding the current one-day format into a two-day session in the future.

Members providing their evaluations or subsequent e-mails are thanked for their input; this feedback will be considered in planning next year's forum.

## COMMON PSR FINDINGS

Again this year, the most significant weaknesses identified by reviewers are inadequate disclosure for not-for-profit organizations and poor documentation of analytical review. Following is a list of findings that occur frequently, broken down in four categories – generally accepted accounting principals, audit, review and notice to readers:

### Generally Accepted Accounting Principals

- No disclosure of a not-for-profit organization's purpose, its intended community of service, its status under income tax legislation and its legal form.
- An organization uses fund accounting but does not provide a brief description of each fund reported.
- The statement of financial position for not-for-profit organizations does not show separately the net assets invested in capital assets, restricted net assets and unrestricted net assets.

It is particularly important to properly disclose net assets invested in capital assets. In NPOs that have a large investment in capital assets, not separately disclosing the components may incorrectly lead users of the financial statements to believe they have an accumulated "surplus" when in a large number of cases they have an accumulated operating deficit which is hidden by the investment in capital assets.

Many practitioners still show net assets as "Members Equity". For most organizations, this caption is misleading since the "equity" would rarely revert to the members in the event of dissolution.

- The required information relating to financial instruments is not disclosed.

Common disclosures to be considered include:

- a) for temporary investments, the interest rates and maturity dates.

- b) For an authorized line of credit, the amount authorized, the interest rate and the repricing date.
  - c) for long term-debt, the repricing date, when earlier than the maturity date.
- Disclosure of related party transactions may be incomplete with regard to:
    - a) free rent or other services and personal guarantees from shareholders.
    - b) the nature of the relationship for transactions or balances owing to and from related parties; terms such as “related” or “affiliated” do not adequately describe the relationship.
    - c) repayment terms and conditions or the absence thereof.
    - d) measurement basis used (cost, exchange value).
  - Line-of-credit borrowings and other temporary loans are included in cash equivalents in the cash flow statement. In this case, contrary to former Section 1540 and apart from allowable exceptions, borrowings must now be considered financing activities.
  - Marketable securities that may fluctuate (shares, mutual funds, bonds, etc.) and term deposits with terms of over three months are included in cash equivalents in the cash flow statement.
  - Income taxes and interest paid are not shown separately on the cash flow statement or in the notes to the financial statements; when disclosed however, the amounts payable rather than *paid* are often noted.

#### Audit

- Inadequate documentation of knowledge of the client’s business, accounting systems, internal controls and the effect of audit risk assessment on the nature, extent and timing of substantive audit procedures.

A permanent file may exist and include systems descriptions, but often there is no evidence that it has been updated in years. If a standard form is used to document knowledge of the business, it should be **thoroughly completed** and indicate that it is reviewed annually.

Often, the audit approach is not specifically documented. If risk is assessed as “low” but a purely substantive approach is planned for reasons of efficiency, this should be noted in the file. For clarification and guidance in this area, practitioners may wish to refer to the Professional Engagement Manual form, *Audit Strategy Memorandum*.

- Insufficient procedures applied to salary expense.

Reconciling salary expense with T4’s may not be a sufficient appropriate auditing procedure for this item. Depending on materiality and the number of employees, consideration should be given to

performing analytical review procedures, on a departmental basis, to the previous year and to budget; obtaining a list of employees and their salaries, signed by management; and making enquiries about new employees, terminations and corresponding salaries.

- Poor documentation of analytical procedures used in evaluating the overall financial statement presentation.

Analytical review may be documented on the draft financial statements or in a memo but *must also address significant changes in balance sheet items*. Care should be taken that comments are not too general in nature.

- Poor documentation of subsequent events and contingencies review.
- Auditor’s report not in accordance with generally accepted accounting principles.

The auditor’s report was prepared in accordance with an appropriate disclosed basis of accounting but referred to GAAP. For suggested wording, see CICA 5100.05 and 5701.14.

- Letter of representation not obtained from management or not updated to include a reference to illegal acts and related party transactions.

#### Review

- Inadequate documentation of analytical review procedures.

As in audits, the analytical review must address significant changes in *both* balance sheet and income statement items, as well as consider the inter-relationship of various items (i.e. significant fixed asset additions with no corresponding change in insurance expense).

- Inadequate documentation of knowledge of the client’s business.

Standard forms used contain brief information or are not fully completed.

- Poor documentation to support the plausibility of inventories, allowance for doubtful accounts, HST, as well as cut-off.

#### Notice to Reader

- An engagement letter was not prepared or signed by the client.

Addressing these weaknesses will contribute toward a positive result from practice review AND save the practitioner money by reducing report write-up time.

## HOW TO KEEP CURRENT ON ACCOUNTING AND ASSURANCE STANDARDS

To stay abreast of the status of assurance and accounting standards consider subscribing to the "What's New?" section of the CICA's Web site at [www.cica.ca](http://www.cica.ca). and you will be one of the first to know about changes in standards.

This service regularly notifies you **by email** of updates to the CICA site. You can choose to subscribe to all sections of the CICA Web site, or specify only certain areas such as Standards and Guidance, Education, Conferences, etc.

## NEW CONSIDERATIONS FOR FINANCIAL STATEMENT PREPARATION THIS YEAR

The following items highlight some of the more significant (and common) changes to accounting and assurance standards which impact financial statement preparation for the current year. Practitioners should review related CICA pronouncements thoroughly before applying.

**CICA Section 1300 (New) - Differential Reporting** and the related differential reporting options became effective for fiscal years commencing on or after January 1, 2002. Under new Section 1300, *profit-oriented* enterprises qualify for differential reporting when they have no public accountability and **all** of their owners, including those not otherwise entitled to vote, unanimously consent. Also, as noted in the PEM newsletter for September 2002, don't forget to ensure that contractual lenders such as the organization's bank understand and accept the use of differential reporting options – the current lending agreement most likely required financial statements prepared using Canadian GAAP.

Sample forms to account for differential reporting options, including sample letters of representation from management and approval letters to be obtained from shareholders will be included in Update #31 of the Professional Engagement Manual.

In addition to selecting which of the available differential reporting options to apply, a qualifying enterprise must disclose in its summary of accounting policies note the fact that it adopted differential reporting and identify which reporting options it applied. Section 1300 Appendix B provides an example of the required note disclosure. Also, see Section 5400.32 - .38 AUDITOR'S REPORT ON FINANCIAL STATEMENTS PREPARED USING DIFFERENTIAL REPORTING OPTIONS for sample wording when differential reporting is adopted.

**CICA Section 3465 (New) – Income Taxes** became effective for all enterprises for fiscal years beginning on or after January 1, 2002. Before the issue of Section 1300 – *Differential Reporting*, an entity could elect to use the predecessor Handbook material that was the deferral

method. Now there is no longer an option to use deferred taxes.

**CICA Section 5135 (Revised), *The Auditor's Responsibility to Consider Fraud and Error*** became effective for fiscal periods ending on or after December 15, 2002.

This revision is a **significant change** to Generally Accepted Auditing Standards and now requires auditors to do more work. All firms performing audits must be aware of and implement changes to their programs and procedures as necessary to comply with the new standard. Update #30 to *The Professional Engagement Manual*, issued in October 2002, included revised planning forms and guidance on how to incorporate the new rules on fraud into practice.

An in-depth discussion of this topic can also be found in the March 2002 issues of Risk Alert (CICA newsletter) and *Focus on PEM*, for members who subscribe to PEM.

**EIC-122 Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced** became effective for fiscal years beginning on or after January 1, 2002 and may impact many clients.

Demand loans with repayment terms, which were previously included in long-term debt, **must now be reclassified as "current" liabilities, except in limited circumstances.**

**ED - Auditor's Association with Documents Containing Financial Statements** is relevant for financial executives, audit committee members and others involved with the issuance of published annual reports, interim reports, or any other type of document offering securities.

In addition to prescribing procedures to be performed, the draft Recommendations include a protocol to follow if it appears a document contains an error or misstatement. They also **extend the auditor's traditional obligation** to read printed copy by requiring procedures to be performed **on electronic versions** filed on SEDAR in Canada (EDGAR in the US) or on the entity's website.

## CONDOMINIUM CORPORATIONS

There have **not** been any changes to reporting requirements for condominium corporations since last year with respect to reserve funds under Regulation 72B. While certain requirements of this regulation still need resolution, the Registrar has indicated that factual information, included in the notes to the statements would be acceptable. Note disclosure may include whether a reserve fund study was performed, by whom, when, contribution recommended by the study and the actual amount collected. Also, details of changes to the reserve fund for the year would usually be provided. The Professional Engagement Manual includes sample financial statements for a condominium corporation, which may be a useful reference.

## COOPERATIVE HOUSING: CHANGES TO REPORTING REQUIREMENTS

On November 28, 2002, the Department of Community Services Housing Services held a conference to review changes to reporting requirements. Arising from this session, a working group of CAs will meet with the Department in mid-January to discuss various reporting issues.

Practitioners with questions or concerns related to financial reporting for housing co-ops may contact Wenda Bennett at ICANS for further information.

## RECORD RETENTION

The November 2002 issue of CARM, a risk management newsletter published by AICA Services Inc., included an article on record retention, destruction and electronic copy.

The article noted that specific procedures must be followed when storing records electronically. For guidance in preventative practice consider obtaining the following publications:

- CCRA's IC78-10R3 - provides information and guidance on methods and ways of keeping records as well as addresses issues *unique* to electronic records and data storage. See [www.ccrardc.gc.ca/E/pub/tp/ic78-10r3](http://www.ccrardc.gc.ca/E/pub/tp/ic78-10r3).
- Microfilm and Electronic Images As Documentary Evidence, published by the Canadian General Standards Board, provides helpful guidelines for image management programs, the capture of images of business source records, and the secure storage of those images. For a copy of this useful resource, call 1-800-665-2472.

## PRACTITIONER SURVEY

Complete results of the 2002 Public Practice Statistics Questionnaire were released to survey participants in December. The results allowed participants to determine whether their practice is competitive with respect to charge out rates, productivity, salaries, benefits, per diem rates, for all levels of staff, as well as computerization, as well as in many other areas.

It was interesting to note that while only 12% of total revenues are derived from audits, there has been a small overall increase in revenue from audit, review and compilation engagements since the last survey. A similar survey in BC showed lower revenues for assurance work, with 35% of total revenue coming from compilations, compared to 26 % in this province.

## AUDITOR'S REPORT – 1902

Speaking to a local chapter of the New York State Society of CPAs on October 16, 2002, former Securities and Exchange Commission (SEC) Chief Accountant Lynn Turner offered some suggestions for accountants to regain the public's trust, such as redesigning their products and standards accordingly, including an expanded audit report.

In his opinion, today's "wishy-washy" audit standards should be replaced with ones that require auditors to perform specific tests and state in their opinions exactly what steps were taken. As an example, below is the report on U.S. Steel from its first audit by Price Waterhouse in 1902. Mr. Turner bet anyone in the room a steak dinner that if they put this report alongside the one used today, nine out of ten investors would say the 1902 report is more meaningful and useful.

*We have examined the books of the U.S. XYZ Corporation and its Subsidiary companies for the year ending December 31, 19XX, and certify that the Balance Sheet at that date and the Relative Income Account are correctly prepared therefrom.*

*We have satisfied ourselves that during the year only actual additions and extensions have been charged to Property Account; that ample provision has been made for Depreciation and Extinguishment, and that the item of "Deferred Charges" represents expenditures reasonably and properly carried forward to operations of subsequent years.*

*We are satisfied that the valuations of the inventories of stocks on hand as certified by the responsible officials have been carefully and accurately made at approximate cost; also that the cost of material and labor on contracts in progress has been carefully ascertained, and that the profit taken on these contracts is fair and reasonable.*

*Full provision has been made for bad and doubtful accounts receivable and for all ascertainable liabilities.*

*We have verified the cash and securities by actual inspection or by certificates from the Depositories, and are of opinion that the Stocks and Bonds are fully worth the value at which they are stated in the Balance Sheet. And we certify that in our opinion the Balance Sheet is properly drawn up so as to show the true financial position of the Corporation and its Subsidiary Companies, and that the Relative Income Account is a fair and correct statement of the net earnings for the fiscal year ending at that date.*

## 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.