



THE PRACTITIONER'S VIEW

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UPDATE: IMPLEMENTING QUALITY CONTROL STANDARDS

Adapted from an article in CheckMark Winter 2005, a publication of the Institute of Chartered Accountants of Ontario.

Last August, the CICA Auditing and Assurance Standards Board released two new *Handbook* sections on *Quality Control* with an effective date of December 2005 (see related article in the December 2004 issue of *The Practitioner's View*). These new standards affect all firms, including sole practitioners who perform assurance (audit and review) engagements, requiring them to develop and document their quality control policies and procedures by December 2005.

To assist members in doing this within their own firms, CICA has engaged Stuart Hartley, FCA, author of the *CICA Professional Engagement Manual* to develop a *CICA Quality Assurance Manual (QAM)*. The *QAM* will be directed specifically to the needs of small firms and sole practitioners. This manual is expected to be available in late spring, probably May. It is also anticipated that PD workshops will be offered to allow members to work through the *QAM* with facilitators, assisting them in developing quality control manuals specific to their individual practices.

Members will be updated as further information regarding the sample manual and training sessions becomes available.

REVENUE RECOGNITION POLICY

EIC 141 - Revenue Recognition, specifically requires each enterprise to disclose its revenue recognition policy in its financial statements, not just when a selection has been made from alternative acceptable accounting principles and methods. Also, it's not enough to just note "income is recognized when earned". Rather, the enterprise must disclose the policy for each material type of transaction if it has different types of revenue transactions, including non-monetary (barter) sales, or for each element if it has multiple elements, such as a product and service.

EIC 141, supplements the general guidance in CICA Handbook *Section 3400 - Revenue*, providing specific criteria to meet for revenue recognition:

- Persuasive evidence that an arrangement exists (reviews factors impacting the assessment whether an arrangement exists);
- Delivery and performance have occurred (discusses "bill and hold" arrangements, customer acceptance of product, "layaway sales" arrangements, non-refundable fee arrangements and licensing fee arrangements); and
- Fixed or determinable sales price exists (discusses cancelable sales, right of return, price protections and/or inventory credit and refundable fee for service).

Additional guidance regarding revenue recognition is also provided in *EIC 142 (Revenue arrangements with multiple deliverable)*, *EIC 143 (Accounting for a separate price extended warranty and product maintenance contracts)* and *EIC 144 (Accounting by a customer, including a reseller, for certain considerations received from a vendor)*. These EICs became effective for fiscal periods beginning on or after December 18, 2003.

Practitioner's View is a regular publication of the Institute of Chartered Accountants of Nova Scotia to inform and to serve members who are involved in public accounting in Nova Scotia.

NON-CONSOLIDATED FINANCIAL STATEMENTS

Practitioners are reminded that the “soft qualification” report that was widely used is no longer available since the introduction of differential reporting and withdrawal of *Auditor’s Report on Non-consolidated Financial Statements Prepared in Accordance with Long-Term Investments, CICA Handbook – Accounting, pars.3050 (.39-.49), Section 5520*. What options are available?

General Purpose Financial Statements

- Issue either a qualified or adverse opinion report (audit or review engagement)

An adverse opinion report is appropriate when the subsidiary operations and/or financial position are significant to a stakeholder of the parent company. It is likely that virtually every account in, and the information provided by way of notes to the financial statements will be materially different. (CICA Handbook Section 5510.17 and .19; also example report 5510.G)

A qualified opinion report is appropriate if 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 (CICA Handbook Section 5510.16)

- Issue a notice to reader communication (compilation engagement)
- Issue a report applying differential reporting

If eligible, an enterprise may elect to adopt differential reporting to account for subsidiaries using either the cost or equity method. (CICA Handbook Section 5400.33 or 8200.13)

Note: Differential reporting options may only be used on general purpose financial statements and paragraph 1300.16 requires that only one set of accounting policies should be used in any one year. Therefore, if an entity prepares consolidated financial statements for its shareholders and also prepares a second set of non-consolidated financial statements for its shareholders, the auditor/public accountant cannot accept an engagement to report on the second set under paragraph 5400.33 (or paragraph 8200.13). Consider whether reporting under Section 5600 (or CICA 8200.14 – .29) is appropriate or whether a reservation is necessary.

Special Purpose Financial Statements

Financial statements prepared under CICA 5600 and 8200 (.14 - .29) must meet the following criteria:

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

(See Appendixes in Section 5600 and 8200 for sample report wording)

Financial statements prepared for income tax purposes on this basis are considered to have been prepared in accordance with legislation.

Financial statements prepared under these sections are not considered general purpose financial statements regardless of the distribution.

If non-general purpose financial statements do not meet the criteria of CICA *Section 5600 or 8200 (.13 - .29)* (for example, if there is a contractual agreement but it is not in writing) then a reservation of opinion may be necessary.

For further discussion of this topic, practitioners may also refer to the CICA staff bulletin *Section 5600: Does it apply to me?* (http://www.cica.ca/index.cfm/ci_id/18728/la_id/1.htm) as well as articles in the December 2003 and 2004 issues of *Risk Alert* (http://www.cica.ca/index.cfm/ci_id/222/la_id/1.htm) and *CAMagazine*, January – February 2004 (http://www.camagazine.com/index.cfm?ci_id=19251&la_id=1)

NEW ACCOUNTING STANDARDS FOR FINANCIAL INSTRUMENTS

The Canadian Accounting Standards Board (AcSB) issued new accounting standards for financial instruments on January 27, 2005, that will impact virtually every entity in Canada, small and large. For many entities, even though the new standards are lengthy, their impact will be modest. In some cases, however, the new standards will require an entity to make significant accounting changes. All entities are encouraged to promptly assess the extent to which these standards will affect them.

The new standards are a culmination of many years of consultation with Canadian constituents and international standard setters. Having explored several approaches to accounting for financial instruments, the AcSB has produced standards that will enhance the understandability of financial statements, are practical and are harmonized with those of international partners.

The AcSB presently has standards in place for disclosures about an entity's use of financial instruments and for presentation of financial instruments when included in the balance sheet. Until now, however, it has not had standards that comprehensively address when an entity should recognize a financial instrument on its balance sheet, or how it should measure the financial instrument once recognized. The new standards will fill this "gap in GAAP".

New Handbook Sections

The new standards comprise three new Handbook Sections:

Section 3855: Financial Instruments — Recognition and Measurement.

This Section will probably affect **all entities** to some degree. It prescribes when a financial instrument is to be recognized on the balance sheet and at what amount — sometimes using fair value; other times using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3865: Hedges

Application of this Section is **optional**. It provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It builds on existing Accounting Guideline AcG- 13, Hedging Relationships, and Section 1650, Foreign Currency Translation, by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

Section 1530: Comprehensive Income.

This Section introduces a new requirement to temporarily present certain gains and losses outside net income.

There are also a number of significant consequential amendments to other Handbook Sections.

Impact on accounting

Financial instruments include accounts receivable and payable, loans, investments in debt and equity securities (including term deposits, guaranteed investment certificates, investments in common shares, etc.) and derivative contracts such as forwards, swaps and options. In many cases, there will be little change from current accounting. An entity with no financial instruments other than cash, accounts receivable, accounts payable and arms' length debt will find little, if any, difference in accounting for these instruments. An entity with investments in common shares, derivatives, or that trades other types of financial instruments will probably be significantly affected.

Implementation guidance

Recognizing that some entities may find the new sections daunting, the AcSB has established a Financial Instruments Working Group, which is charged with assisting in the development of Implementation Guidance to help apply the standards. AcSB staff members also expect to issue materials to assist in understanding the new requirements. For example, articles in the November and December 2004 issues of CAmagazine, explain how one might go about preparing to adopt the new standards.

Effective date

The mandatory effective date is for annual and interim periods in fiscal years beginning on or after October 1, 2006. (In many cases this will mean application to calendar years beginning on January 1, 2007.) However, early adoption is permitted. While the mandatory effective date might seem some way off and comparative figures will not be affected, significant implementation planning may be necessary for larger entities that make extensive use of financial instruments. These entities are encouraged not to delay in reviewing the new standards and considering the consequences for their organizations.

Further information about the new standards, and related implementation guidance, is available on the Financial Instruments project page of the AcSB website at www.acsbcanada.org.

Please contact Ian Hague (416-204-3270/e-mail: ian.hague@cica.ca) or Kate Ward (416-204-3437/e-mail: kate.ward@cica.ca) if you require any additional information.

ACCOUNTING FOR SUCCESSFUL FARM MANAGEMENT

The following article appeared in a February 2005 Public Practice Bulletin, a publication of the Institute of Chartered Accountants of Alberta and is reprinted with permission. Opinions expressed in this bulletin are those of the author and do not reflect the official position of ICAA.

The complete eight publication series on Accounting for Successful Farm Management is now available from CICA. These publications provide guidance for Canadian agricultural producers so that they could respond to the industry's need for consistent application of common accounting and reporting practices that comply with Canadian Generally Accepted Accounting Principles (GAAP). The series is produced under the auspices of the Canadian Farm Business Management Council through its Agricultural Accounting Standardization Committee. It is endorsed by CICA as a significant contribution to the acceptance of GAAP for Canadian agricultural producers.

There is a publication for each of the following agricultural sectors:

1. DAIRY
2. GRAINS & OILSEEDS
3. POULTRY
4. BEEF
5. SWINE
6. HORTICULTURE — POTATOES & FIELD CROPS
7. HORTICULTURE — TREES & VINES
8. HORTICULTURE — NURSERIES & GREENHOUSES

Each publication is designed with the following components:

General Introductory Sections

- a) Outlining the status of agricultural financial accounting and reporting and the need for standardization.
- b) Identification of common accounting and reporting issues of the agricultural industry.

Specific Sector Sections

- c) Sector commentary.
- d) Sector sample Financial Statements, including example notes to financial statements.
- e) Sector narrative outlining the recommended treatments and methodologies —emphasizing capitalization and costing processes.
- f) Illustrative examples of sector accounting procedures.
- g) Illustrative chart of accounts for the sector.

Two Key Issues Identified in Agricultural Industry

1. Inventories

Valuation of inventories varies in the industry and accordingly is identified as one of the most significant impediments to comparability of financial information among producers within the commodity groups.

The publications emphasize the valuation of inventories at the lower of cost and market (net realizable value) as the most appropriate valuation basis (as per CICA Handbook Section 3030). In each of the publications, guidance is provided on obtaining the respective historical cost information (determined on the directing cost method) so that this valuation basis can be applied.

NOTE: CICA initiated in April 2004, a project proposal to develop a new inventories standard. This project will consider the recently amended standard of the International Accounting Standards Board with respect to inventories (IAS 2) which advocates a market valuation standard and will include a review of the treatment of inventories related to agricultural produce beyond the point of harvest.

2. Capitalization of Productive Assets

Although not being applied consistently within the agricultural industry, the capitalization of productive assets is being recommended by the series of publications.

Such capitalization is consistent with CICA *Handbook Section 3061* criteria for capitalization. Systematic amortization of the cost, net of residual value is also being recommended.

Other Financial Statement Presentation Features Being Recommended by Publication Series

Expenses to be classified as either production or other

It is felt that classification of expenses should be consistent within the industry. The publications recommend, for the purposes of uniformity and practicality, that certain expenses be classified accordingly and provide guidance regarding the classification to either production or other.

Cash flow financial statements to be prepared on the direct method of reporting cash flows from operating activities

Three factors support this recommendation:

- a) Gross cash receipts/payments information is easily obtained from the accounting records of the agricultural enterprise.
- b) Producers and other users understand gross cash flow information.
- c) Gross cash flow information is useful in preparing future cash flow projections.

Contribution margin format

The contribution margin format is being recommended as it enhances the decision-making capabilities of management. This involves the presentation of production expenses in the statement of income as an item before and separately from "other" expenses. The contribution margin amount is the amount arrived at after deducting from revenues the production expenses and before showing the "other" expenses.

A schedule of contribution margin, providing detail of components, is presented. This schedule reflects the respective %s of each component item to total revenue.

Economic dependence

There should be disclosure of economic dependence in agricultural commodity group financial statements, when appropriate. Situations involving supply management programs, tariff protection, export controls contracts with third parties and limited market outlet sources are examples where conditions of economic dependence may exist.

Management salaries presentation

The recognition of management salaries as a separate line item, immediately before the provision for income taxes, is being recommended so as to not impede comparative performance analysis of operational results among family farm corporations, partnerships and proprietorships.

Conclusion

Although the eight publications series "Accounting for Successful Farm Management" is not, by definition, a primary source of GAAP, it is a worthwhile resource to be consulted. Members can order individual publications or the complete set via the CICA website at www.knotia.ca.

MORE ON SUCCESSION PLANNING

The following article appeared in the Winter 2005 issue of Checkmark, a publication of the Institute of Chartered Accountants of Ontario and is reprinted with the permission of ICAO.

Do you have a plan in place to transition your clients should you decide to retire? Have you considered selling your practice? What would happen to your practice if suddenly you were unable to work, perhaps as a result of a disability or death? If these situations are of concern, you'll be interested to know that the CICA has initiated a project entitled *Succession Planning*. The Ontario Institute will be providing support and collaboration for this project. Still in its preliminary phase, the intention is to define succession planning and provide guidelines on building and implementing an exit strategy.

YOUR ABILITY TO ACT AS AN EXECUTOR OR TRUSTEE FOR YOUR CLIENTS

The following article appeared in the Winter 2005 issue of Checkmark, a publication of the Institute of Chartered Accountants of Ontario and is reprinted with the permission of ICAO. (Also, see related article in the November 2004 issue of The Practitioner's View)

Have you been asked by your client to be an executor of his/her will and/or a trustee of his/her estate? Is your ability to act in this manner impacted by the Independence Rule of Professional Conduct 204? The answer is probably yes.

You need to consider that as a trustee or an executor you can influence the financial direction of the trust or estate, irrespective of your level of involvement or the number of trustees/executors with whom you share this responsibility. This could trigger issues with a number of aspects of the Independence Rule, such as:

- This role is not dissimilar to serving as an officer or director of an entity, since you have the ability to exercise influence over the financial and accounting policies of the trust or estate. Rule 204.4(18) precludes a member or firm from performing "an assurance engagement for an entity if a member of the firm serves as an officer or director for the entity."
- A trustee or executor can be viewed as having a management function, by having the ability to exercise authority or by being actively involved in decision-making. According to Rule 204.4(22), "a member or firm shall not perform an assurance engagement for an entity if, during the engagement period, a member or firm makes a management decision or performs a management function".
- According to Rule 204.4(1), a member or student is not allowed to participate on an assurance engagement if the member or firm, or his/her immediate family, holds, as a trustee, a direct or indirect financial interest in the client. Per paragraph 64 of the Council Interpretations to Rule 204.4, this is viewed no differently than holding the interest as the beneficiary.
- There are further restrictions on the ability of the office of the firm to complete an assurance engagement if the member involved is a partner; Rule 204.4(4) states that "a member who is a partner of a firm and who holds, or whose immediate family holds, a direct financial interest or a material indirect financial interest in an audit or review client shall not practise in the same office as the lead engagement partner for the client."
- The basic rule of thumb test of how a reasonable observer would view the relationship should also be applied.

Is the nature of the threat such that safeguards could be introduced to reduce the threats to an acceptable level? No, there are generally no safeguards for these types of financial interest and self-review threats, only specific prohibitions.

Your options are limited, so what role — if any — can you play? One possibility, if you want to continue providing assurance services rather than acting as a trustee, is to take on an advisory role to the trustees that involves no decision-making power. You will also need to assess whether you have inadvertently taken on a de facto decision-making role. Each situation must be reviewed based on its own merits within the independence rule framework. Another possibility to consider is whether someone who is no longer associated with your firm could be appointed, such as a retired partner. You would need to evaluate the level of association that the retired partner has with the firm; paragraph 33 to the Council Interpretation to Rule 204 provides some guidance in this area. Remember to document the scenario, your evaluation and your conclusions in your files, and also make sure that firm policies are otherwise being met.

In addition to the limitations regarding assurance engagements, you may also be precluded from providing other assurance services that require you to be independent. You could, however, provide non-assurance services that do not require the member or firm to be independent, such as compilation engagements, as long as the nature of the relationship is described in the report or notes to the financial statements. For further information refer to Rule 204.8. Note that if you accept the appointment, there is also the possibility of triggering conflict of interest issues if there are multiple beneficiaries who are your clients and conflicts arise.

Another consideration is that there are limitations on executor fees. Complications that arise could result in less than a full recovery of a CA's standard rates. Remember that an executor's role involves getting control of and managing property of the deceased. This also means dealing with any skeletons left in the closet. Do you really want this responsibility, unless you have a close personal relationship with this client?

You may think you can postpone consideration of these issues since your assurance client who has asked you to be an executor or trustee is still alive. However, the independence issue will arise upon your client's death. At this time, it will be too late for your client to select an alternative executor if you choose to continue to provide the assurance services. Be proactive and make these decisions now.

When you have accepted a role as trustee or executor, please keep in mind other Rules of Professional Conduct, such as Rules 212.1 and 212.2 that discuss handling of trust funds and other property and handling property of others.

Additional steps you may want to take before accepting a role as a trustee or executor include:

- checking whether your role falls within the parameters of your professional liability insurance policy, or whether additional insurance coverage is otherwise in place or prudent to obtain; and
- possibly consulting with a lawyer to make sure you are aware of all of your legal responsibilities.

FINTRAC - COMPLIANCE QUESTIONNAIRES

The following article appeared in the February 2005 issue of News 'N Views, a publication of the Institute of Chartered Accountants of British Columbia and is reprinted with the permission of ICABC.

We understand that FINTRAC, the federal agency responsible for compliance of reporting requirements under the *Proceeds of Crime (Money Laundering and Terrorist Financing Act* (the Act), is sending out requests to complete an online questionnaire to accounting firms enquiring about the compliance regime to report suspicious and prescribed transactions.

If you receive such a request, don't panic! The requirement for a compliance regime under Part I of the Act is applicable to members in public practice only if you are acting as financial intermediaries. If you are not acting as a financial intermediary, you do not need to set up a regime to report suspicious and prescribed transactions, so just fill out the general contact information in Part A of the compliance questionnaire and submit it to FINTRAC.

Your firm is a financial intermediary if your firm carries out any of the following on behalf of clients:

- Receive or pay funds;
- Purchase or sell securities, real property or business assets or entities;
- Transfer funds or securities by any means; or
- Give instructions on behalf of any person or entity in respect of the above three activities; or
- Receive professional fees in respect of the above four activities.

We caution member, that it may be quite possible that they are financial intermediaries when they act for clients who live out of the country most of the year and the firm accepts funds in trust to pay bills, or collect revenue from rent properties. This may also include those of you who operate an Eldercare or PrimePlus practice and are paying bills for clients on the behalf.

If you are a financial intermediary, then you do need to set up a compliance regime. For further information about such a regime, visit (a) CICA's website at www.cica.ca and select Money Laundering under Research and Guidance and (b) FINTRAC's website at www.fintrac.gc.ca and look under Information for Accountants.

We remind members that they are still required to report cross border transfers of currency or monetary instruments at or above a specified threshold (\$10,000) the Canada Border Services Agency. We encourage members to visit CICA's and FINTRAC's website to learn more about an accountant's responsibilities under the legislation.

Finally, if you have clients who are financial intermediaries, this may be a service opportunity for you to assist them in setting up a compliance regime. At the same time, we do suggest members be mindful of the possibility of money laundering activities and not unknowingly become associated with unlawful activities.

TAX ISSUES

The following article appeared in the February 2005 issue of News 'N Views, a publication of the Institute of Chartered Accountants of British Columbia and is reprinted with the permission of ICABC.

It's Income Tax Time Again

Most of you are heading into your busiest time of year preparing and delivering hundreds of personal income tax returns. We'd like to remind you, as we have done in years past, of a few simple and effective ways to help protect you and your clients from misunderstandings that happen from time to time. These suggestions may seem quite basic but we continue to see a need for improvement in this area in a large number of offices we visit.

Engagement Letters

We continue to see more and more firms suing engagement letters for their personal income tax engagement letters for their personal income tax clients. The coming into force of the privacy legislation on January 1, 2004 makes the implementation of a personal income tax engagement letter worth serious consideration. Most oT1 software packages have the ability to generate engagement letters and can be edited to ensure you cover off the following items that should be in the letter:

- Responsibility of the client to provide accurate and complete information
- Responsibility of the client for the accuracy and completeness of the final return
- Confidentiality of client information
- Client consent allowing you to use their personal income tax information in preparing another family members return (e.g. medical expenses allocation of dividend income)
- Use and distribution of the completed income tax return

Income Tax Transmittal Letters

A properly written transmittal letter to your clients accompanying the income tax returns you prepare will serve to minimize the instances of discontented clients claiming interest and penalties are owing due to the fact that you didn't communicate the appropriateness of the information to them. Many practitioners claim that such a letter is not necessary as they personally meet with each client and go over the issues that a good transmittal letter would cover. While this may be true, a transmittal letter provides evidence of the discussion with your client, in the event a "problem" arises at a later date, as well as a handy reference for your client and a permanent record of the discussion for both your and their files. A hard copy of the letter accompanying the returns should be kept in your client file.

The letter can be your own or one that is included with your income tax return preparation software and should include the following items:

- The date as evidence of when you communicated with and delivered the income tax return to your client. It is important to print a copy of the letter for your file, as most computer programs will automatically date the letter on the date printed if required in the future.
- Filing instructions, including the due dates for the return being filed and for the payment of any balance owing.
- Installments required for the next taxation year.
- Information regarding balances carrying forward such items as RRSP contribution limits and undeducted amounts as appropriate.

In addition, you may wish to discuss other issues such as your involvement, if any, with foreign asset reporting or specifically address the fact that a requirement does exist and that you have not done anything to meet that requirement.

Also, if you file the income tax returns for clients in paper form it is a good practice to have a transmittal letter to the Canada Revenue Agency. The letter should detail the types of returns being filed, the clients' names and identification numbers if more than one is being filed at a time. In addition, it should be sent in duplicate so CRA can receipt one copy and return it to you as evidence of filing. Given the introduction of privacy legislation, as mentioned above, you are required to have your client's consent to file their income tax return on their behalf.

File Storage

It is becoming fairly common for practitioners not to produce a complete paper copy of their client's personal income tax returns for their own files. If this is the case, you should still print a copy of the transmittal letter as discussed above. In addition, the electronic version of each return should be saved in PDF format. This will allow you to access the return without requiring the specific income tax software used to prepare it. It also ensures that changes cannot be made to the return and allows you to provide your client, or others as directed by your client (such as the bank), a complete copy of the return in electronic format.

Compilation of Income Tax Information

We would like to remind you except in rare circumstances, the preparation of a number of personal income tax forms such as self employment and rental income schedules are compilations engagements as envisioned by Section 9200 of the *CICA Handbook*. Copies of these schedules are frequently distributed by your clients to third parties for the purposes of applying for financing. As a result, all pages of each schedule prepared and given to the client should have a Notice to Reader on them or refer to a separate Notice to Reader. In addition, your file should contain adequate support for the significant figures included in the schedules and in the rest of your client's return.

Electronic Filing

Finally, for practitioners filing client income tax returns electronically, we remind you of the following points that have caused members problems in the past:

- Do not have your client sign a blank T183;
- Do not file your client's return before the client has signed and dated part F of the T183;
- Review your client's direct deposit, alternative address and representation authorizations before filing their return to ensure no changes have occurred since last years' return was filed; and
- Retain the original copy of the Form T183.

SUGGESTIONS FOR THE NEXT ISSUE?

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