

Memorandum

To	All Practicing Offices	From	David Glass, CA Chair, Office Practice Assistance Committee
Subject	FOCUS ON PRACTICE INSPECTION FINDINGS		Kathy Zaplitny, CA Director of Members' Services
Date	October 2008		

Background

The Office Practice Assistance Committee reviews the annual practice inspection results to identify those areas where adherence to CICA Handbook recommendations could be improved. While the results of the inspections conducted from September 2007 – August 2008 were generally favourable (80% no further action), the Committee has expressed concern regarding the frequency of certain findings in the areas of implementation of quality control policies and procedures, performance of audit, review and compilation engagements and financial statement presentation that contributed to the Committee's decision to reinspect approximately 20% of all offices inspected during that year (10% in 2006-2007).

This memorandum outlines the common findings, provides direction for addressing deficiencies and summarizes significant new accounting and assurance standards and sources of guidance to assist practitioners in implementing the new standards.

GENERAL STANDARDS OF QUALITY CONTROL FOR FIRMS PERFORMING ASSURANCE ENGAGEMENTS and QUALITY CONTROL PROCEDURES FOR ASSURANCE ENGAGEMENTS

The most common findings noted in these areas include:

1. Documentation of Quality Control Policies and Procedures

In accordance with GSF-QC, *General Standards of Quality Control for Firms Performing Assurance Engagements*, all firms performing assurance engagements were to have their quality control policies and procedures implemented and documented by December 1, 2005 (January 1, 2005 for CPAB registrants). While there were still practitioners who had not documented their quality control policies and procedures in the form of a quality control manual, the number of such instances was significantly lower in the 2007-2008 inspection year than in the previous inspection year.

2. Assessment of Independence and Client Continuance or Acceptance

Section 5030 – *Quality Control Procedures for Assurance Engagements*, requires practitioners to perform appropriate procedures regarding the acceptance or continuance of client relationships and independence matters for audit and review engagements. The working papers for audit and review engagements should include documentation to evidence the assessment of independence and client continuance or acceptance. In addition, communication of independence is required for both audit and review engagements.

Resources

If practitioners are unsure as to whether certain activities are prohibited or constitute threats to their independence, they can access the *ICAM Rules of Professional Conduct* and related *Council Interpretations* on the ICAM website (www.icam.ca). Rules 204.1 to 204.8 contain the independence standards that were effective for engagements relating to reporting periods commencing after December 31, 2003. The related Council Interpretations provide additional information and guidance.

The Professional Engagement Manual (PEM) and the Quality Assurance Manual (QAM) both provide checklists that can be used to document independence and client continuance and acceptance considerations.

3. Monitoring

There are two aspects to the monitoring requirements as prescribed in GSF-QC. First, the firm is required to review the quality control policies and procedures established to determine whether they remain appropriate. In

addition, the firm is required to inspect a selection of completed assurance engagements to ensure that they have been completed in accordance with the standards. GSF-QC does not prescribe how often the monitoring is to be performed; however, it does require, at a minimum, an annual communication of the results of the monitoring process to all appropriate individuals within the firm. Since GSF-QC became effective December 1, 2005, the first annual monitoring of the system would, in most cases, have occurred towards the end of 2006. Many firms inspected during the 2007-2008 inspection year had not conducted annual monitoring since establishing a system of quality control in 2005.

Annual monitoring is conducted to ensure that the firm's policies and procedures are updated to reflect both changes in standards and changes in the firm. Inspection of individual engagements, however, can be done on a cyclical basis. Engagements selected for inspection would include at least one engagement for each practitioner over an inspection cycle which would span no more than four years. The objective of the inspection process is to ensure that the firm's policies and procedures are being followed and that assurance engagements are completed in accordance with assurance standards. As GSF-QC became effective December 1, 2005, an inspection of a selection of completed assurance files should, in most cases, occur prior to December 1, 2009. Many of the firms reviewed during the 2007-2008 inspection year had not completed an internal inspection of completed files and had not given consideration to how and when this requirement would be addressed.

Practitioners are reminded that ICAM inspections are not a substitute for the firm's own internal monitoring process; however, a firm may take into account the scope or conclusions of the ICAM review or other independent external inspection when determining the scope of an internal inspection.

Resources

Practitioners interested in obtaining a refresher on the requirements of GSF-QC and Section 5030, sharing best practices and discussing implementation concerns with colleagues are encouraged to attend the ICAM seminar, *Quality Control Revisited*, on February 26, 2009.

AUDIT ENGAGEMENTS

As the new audit risk approach was effective for fiscal years beginning on or after January 1, 2006, most of the audit engagements reviewed during the 2007-2008 inspection year were impacted by these standards. While a majority of the firms inspected during that period successfully implemented most of the specific new requirements, a number of firms made no attempt to implement the new standards. This deficiency was the main contributor to the increase in reinspection rate for the 2007-2008 inspection year.

The more common **documentation** deficiencies noted for audit engagements were in the following areas:

1. Understanding of the control environment and the entity's risk assessment process

The control environment includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance to the entity. The auditor should consider the following elements:

- Communication and enforcement of integrity and ethical values;
- Commitment to competence;
- Participation by those charged with governance;
- Management's philosophy and operating style;
- Organizational structure;
- Assignment of authority and responsibility; and
- Human resource policies and practices.

In evaluating the entity's risk assessment process, the auditor should determine how management identifies business risks relevant to financial reporting, estimates the significance of the risks, assesses the likeliness of their occurrence and decides upon actions to manage them.

2. Understanding and testing of internal control

As part of the understanding of internal control referred to above, the auditor is required to obtain an understanding of the information systems, including business processes that are relevant to financial reporting including:

- Classes of transactions that are significant to the financial statements;
- Procedures, including IT and manual, by which transactions are initiated, recorded, processed and reported in the financial statements;
- Accounting records, electronic or manual, supporting information, and specific accounts related to the above procedures;

- How information systems capture events and conditions, other than classes of transactions, significant to the financial statements; and
- Financial reporting processes used to prepare the financial statements, including significant accounting estimates and disclosures.

In addition, the auditor should obtain an understanding of the major types of activities that the entity uses to monitor internal controls over financial reporting, including those related to control activities relevant to the audit, and how the entity initiates corrective actions to its controls. The auditor designs procedures (i.e. walkthroughs) to evaluate the design of internal controls and to determine whether the internal controls have been implemented. Evaluating the design and assessing the implementation of internal controls are required regardless of audit strategy.

The understanding of internal controls should be sufficient to allow the auditor to assess the risk of misstatement at the assertion level and design further audit procedures in response to the assessed risks. If the auditor's assessment of the risk of misstatement includes an expectation that the controls are operating effectively, the auditor will have to perform tests of controls to obtain sufficient appropriate evidence that the controls were operating effectively during the period under audit to be able to reduce the scope of substantive procedures.

Resources

A new PEM chapter, *Risk and Internal Control* (Update #40) addresses the nature of internal control.

ICAM is offering a seminar, "*Control Documentation & Assessment: A Top-Down Approach*", that addresses internal control in the context of audit requirements. This seminar includes a discussion of a simplified approach to documenting controls for small organizations and not-for-profit organizations. The course also provides guidance on when to consider testing controls and how to perform walkthroughs.

3. Assessment of the risk of material misstatement

The assessment of the risk of material misstatement should be conducted at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures. In assessing the risk of misstatement, fraud risk factors and significant risks should be considered.

The assessment of risk at the financial statement level is affected by the auditor's understanding of the control environment. In addressing risks at the financial statement level the auditor determines overall responses such as staffing and timing of audit procedures.

To address risks at the assertion level, the audit plan should provide a clear linkage between the risk assessment and the nature, timing and extent of the auditor's further audit procedures. It has been noted that many firms are not considering the risks identified during the risk assessment process when developing the detailed audit plan and, as a result, the nature and extent of audit work conducted to address the identified risks is often either insufficient or excessive.

4. Consideration of the risk of material misstatements in the financial statements due to fraud

The auditor is required to obtain an understanding of management's assessment of the risk of material misstatement due to fraud, the internal controls in place to address such risk and prevent fraud and management's awareness of any known or suspected fraud. The planning documentation should include evidence that the audit team (or sole practitioner) has considered the susceptibility of the entity's financial statements to misstatement due to fraud. The documentation in the file should include evidence that the auditor has made enquiries of management with respect to:

- The risk that the financial statements might be materially misstated due to fraud;
- Processes for identifying and responding to risks of fraud in the entity;
- Communications, if any, to the audit committee or equivalent regarding processes for identifying and responding to risks identified;
- Communications, if any, to employees of its views on business practices and ethical behaviour; and
- Knowledge of any actual, suspected or alleged fraud.

In addition, the auditor should obtain an understanding of how those charged with governance exercise oversight of management's processes and internal controls for identifying and responding to the risk of fraud and whether they have knowledge of any actual, suspected or alleged fraud.

Resources

Two new PEM chapters, *Risk and Internal Control* and *Making Audit Enquiries*, included in Update #40, address the nature of fraud and provide practical guidance on interviewing techniques and evaluating results.

ICAM is offering two PD seminars on fraud, "*Addressing Fraud*" and "*Reacting to Fraud*" during the fall/winter PD program.

5. Use of analytical procedures

The auditor should use preliminary analytical procedures as part of the risk assessment process to obtain an understanding of the entity and its environment. Analytical procedures should be performed with respect to revenue and consideration should be given to unusual or unexpected relationships that may indicate risks of material misstatement due to fraud.

In addition, the auditor should apply analytical procedures at or near the end of the audit to form an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity. If such analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information, the auditor should investigate and obtain adequate explanations and appropriate corroborative audit evidence.

6. Documentation

Section 5145 – *Documentation* became effective for fiscal periods beginning on or after November 1, 2006. This Section requires audit documentation to be sufficient to enable an understanding of:

- The nature, timing and extent of audit procedures performed;
- The results of audit procedures and the audit evidence obtained;
- Significant findings or issues arising during the audit and the conclusions reached; and
- The identifying characteristics of the specific items tested.

Practitioners are reminded that if the above points are not addressed in the documentation of substantive audit procedures and tests of controls, the procedures are considered to have not been performed.

Section 5145 has also introduced a requirement with respect to assembling a complete and final audit file within 45 days of the report release date. Auditors are now required to document the report release date and completion date in their files.

Areas in which the documentation of substantive audit procedures were found to be weak include testing of journal entries, management estimates, subsequent events review, revenue, expenses and payroll.

Additional Resources for Implementing Audit Risk Standards

PEM Updates #36 - #40 include numerous new forms to assist practitioners in the implementation of the audit risk standards. Each Update has provided successively simplified or condensed forms to make them easier for practitioners to use and many forms have been redesigned for very small entities. A Guide to the 6-step risk assessment process is also included (Form 500). Update #39 contains a new chapter which summarizes the main aspects of performing a risk-based audit for a small not-for-profit organization. Update #40 includes new chapters focusing on the nature of internal control and making audit enquiries.

Many of the PEM forms are presented as worksheets and should be used only where applicable. PEM worksheets are not requirements but are tools to help document evidence as required by the standards. Practitioners must use their professional judgment to tailor the procedures to suit the entity. The authors of the PEM suggest that the key forms to complete are the Risk Register and the Control/Risk Matrix to help document weaknesses and how they are mitigated. The emphasis is to closely link the audit procedures with the identified risks.

The CICA Audit Technique Study "*Audit of a Small Entity, 3rd Edition*" has been updated to reflect the changes in assurance standards. This third edition provides guidance on how to conduct an effective and efficient audit of a small entity in the context of current practice and standards. In particular, this publication discusses the characteristics of a small entity and an audit of a small entity; considers how new standards on audit risk, quality control, internal control and fraud considerations apply to the audit of a small business; addresses the impact of independence rules on the auditor of a small business; and discusses common audit problems and auditor-client relationships in a small business audit context.

Guidance on implementing the audit risk standards can be accessed on the CICA Implementation Support Gateway (<http://cpd.cica.ca/ssg/About.cfm>).

ICAM is offering three seminars to help practitioners design efficient and effective audits: “*A Practical Approach to Audit of Simple (Small & Medium) Entities*”, “*Preparing Working Papers for an Audit*” (profit-oriented entities), and “*Preparing Working Papers for a Small Not-for-Profit Audit*”. The latter two seminars include complete sample working paper files.

7. Communication with those having oversight responsibility for the financial reporting process

Auditors are required to communicate at least annually to the audit committee or equivalent confirming their independence and disclosing all relationships between the auditor and the entity and its related entities that may reasonably bear on the auditor’s independence. In addition, for entities with public accountability, **which include not-for-profit organizations**, this communication should include disclosure of the total fees charged for audit and non-audit services provided by the auditor to the entity and its related entities. The communication should cover the period from the date of the last independence letter to at least the report date.

Prior to completion of the audit, entities with public accountability are also required to communicate to the audit committee or equivalent a summary of the audit approach, the level of responsibility assumed by the auditor under Canadian generally accepted auditing standards and the audit and non-audit services to be provided to the entity and its related entities. As one of the purposes of this communication is to encourage the audit committee to identify areas of concern for the audit, the communication should take place before the field work for the audit begins. Verbal communications should be documented in a memo outlining details of the discussion.

The auditor is also required to communicate significant weaknesses in internal control to both the audit committee or equivalent and management. This requirement applies equally to the audits of owner-managed and smaller entities, and while there may be cost/benefit considerations as to whether the control deficiencies will be addressed or not, these decisions should be made by management and not the auditor.

Resources

Practitioners interested in obtaining additional guidance in this area should attend the half-day ICAM seminar, “*Auditor Communications under GAAS*”.

REVIEW ENGAGEMENTS

Common deficiencies with respect to review engagements relate to documentation in the following areas:

1. Inter-relationship/comparison of revenues, expenses, gross margin, operating ratios and balance sheet items

The lack of documentation of an analytical review of the financial statements is considered to be a serious deficiency. The Committee noted that the practitioner should focus on key financial statement items or aspects of the client’s business, and ensure that checklists, where used, are supplemented by further appropriate documentation. Even if there are no unusual amounts, variances or trends, a comment on the plausibility of key items should be included on the checklist or referenced to a specific working paper as evidence that the practitioner gave such items due consideration.

2. Cut-off procedures

Checklist questions usually suggest that additional documentation be included in either the working papers (cross-referenced to the checklist) or the comments column of the checklist. Typically, documentation would include a description of procedures followed by the client to ensure proper cut-off, a conclusion on the adequacy of the procedures and, if deemed necessary, details of any additional review procedures required to assess plausibility. Completion of a checklist without additional comments is not considered to be sufficient documentation.

3. Inventory – client’s count procedures

As noted above with respect to cut-off procedures, completion of checklists without additional documentation is not considered sufficient. A description of inventory count procedures should include more than just the date of the inventory count; matters such as count instructions, use of count tags, supervision, segregation of obsolete and slow-moving inventory and inventory on consignment should be noted.

4. GST & PST – plausibility of amounts

Consideration should be given to whether copies of the year-end GST and PST returns are sufficient documentation. The courts have found CA firms at fault for not reviewing the plausibility of GST and/or PST. The September 2004 issue of CICA’s Practice Advice suggests that practitioners should consider performing a plausibility test in addition to reviewing year-end GST and PST returns. In addition, the verdict in a recent case (*Bloor Italian Gifts Ltd. vs Dixon*) described in the Spring 2008 issue of the Institute of Chartered Accountants of Ontario publication *CheckMark* (www.icao.on.ca/Resources/Publications/1017page8856.pdf) provides support for this level of work in the area of PST and GST.

Resources

The CICA Assurance and Related Services Guideline AuG-20, *Performance of a Review of Financial Statements in Accordance with Sections 8100 and 8200*, provides specific guidance and direction with respect to various aspects of review engagement documentation. In addition, ICAM is offering a full-day seminar on conducting review engagements on February 3, 2009.

COMPILATION ENGAGEMENTS

The recurring deficiency noted with respect to compilation engagements is as follows:

1. Communication

The standard wording for the notice to reader communication changed for reports issued on or after July 1, 2007. The new wording can be found in Section 9200. A number of firms inspected during the 2007-2008 inspection year had not appropriately implemented the new notice to reader wording for reports issued on or after July 1, 2007.

Resources

Practitioners interested in obtaining an update on the standards relating to compilation engagements and discussing best practices and areas of concern with colleagues are encouraged to attend the ICAM session, *Compilation Engagements* on January 8, 2009.

FINANCIAL STATEMENT PRESENTATION

Common deficiencies with respect to financial statement presentation and disclosure include:

1. Cash Flow Statements - disclosure of interest and income taxes paid, classification of cash flows between operating, investing and financing activities and treatment of non-cash items.
2. Disclosure of the details of authorized share capital.
3. Disclosure of security for short-term bank indebtedness.
4. Classification of demand loans and related party loans with no fixed terms of repayment as long-term when file documentation supports a current liability classification. Callable debt with term provisions for repayment, where the lender has not signed a waiver, should be classified as current as required by EIC 122, *Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced*.
5. Disclosure of related party transactions including identification of transactions as related party transactions and disclosure of terms and conditions for amounts due to/from related parties and the measurement basis used.
6. Disclosure of the revenue recognition policy, which is now required for all profit-oriented entities in accordance with EIC-141. When there is more than one revenue stream, the policy for each material stream should be disclosed.
7. Classification of retractable redeemable preferred shares as equity when file documentation supports a liability classification and the differential reporting option that would allow equity presentation has not been implemented.
8. Various disclosures required when an entity applies differential reporting options.

In the prior year, the Committee noted recurring deficiencies relating to not-for-profit financial reporting and disclosures regarding financial instruments. The Committee is pleased to report that the frequency of findings in these two areas has significantly declined during the 2007-2008 inspection year.

Resources

Practitioners interested in obtaining an update on financial statement presentation and disclosure requirements should attend the ICAM workshop, "*Financial Statement Presentation and Disclosure Workshop*", on either November 12, 2008 or February 25, 2009.

KEEPING CURRENT WITH NEW STANDARDS

1. Transition to International Standards of Auditing

The Auditing and Assurance Standards Board (AASB) has undertaken to adopt the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB). The IAASB is currently undertaking its clarity initiative to amend the ISAs to make them more understandable and to help in implementation, a process which is expected to be completed by late 2008. ISAs will be adopted in Canada in

concert with the IAASB's Clarity Project, and it is anticipated they will be effective for audits of periods beginning on or after December 15, 2009.

Resources

In 2007, the CICA launched the profession's Transition to International Standards website. This site provides information and learning resources on the transition to International Financial Reporting Standards (IFRSs) and ISAs. During the transition period and beyond, this site will evolve to keep pace with the changing needs for education, clarification and knowledge development. Access to the site is through the Transition to International Standards button on the CICA or ICAM websites.

The CICA has prepared an overview of how existing Canadian Handbook-Assurance sections dealing with financial statement audits compare to the ISAs which will become Canadian Auditing Standards (CASs). This comparison identifies the current Canadian Handbook section equivalent for each ISA and any additional requirements of which Canadian auditors must be aware. This overview is summarized in the publication, *CICA's Guide to ISAs in Canada* which is available for download on the Transition website and in hardcopy at ICAM.

The August 2008 issue of CA Magazine includes an article on what Canadian auditors can expect when ISAs are adopted in two years. *No Rest for the Auditor* may be accessed at:
<http://www.camagazine.com/4/5/4/4/9/index1.shtml>.

Practitioners who perform audit engagements are encouraged to attend the free half day ICAM session, *Assurance – Transition to International Standards* on October 14, 2008. Rural practitioners who are unable to attend this session may participate via conference call.

2. Transition to International Financial Reporting Standards (IFRSs)

In February 2008, the Accounting Standards Board (AcSB) confirmed 2011 as the official changeover date for publicly listed Canadian companies to start using IFRS. The transition will affect interim and annual financial statements relating to years beginning on or after January 1, 2011 and will significantly impact financial reporting for all publicly accountable enterprises.

Resources

The Transition to International Standards website currently contains comprehensive information and learning resources on the transition to IFRS including:

- Implementation support
- Industry support
- Sample illustrative financial statements
- Guidance for first-time adopters (IFRS 1)
- Resources specifically for academics
- Comparisons of US GAAP to IFRS
- Comparisons of Canadian GAAP to IFRS
- Descriptions of available courses, conferences and publications

To assist members in obtaining a basic understanding of IFRS, the CICA is sponsoring a free IFRS e-learning course which should be available this fall. The October/November edition of Folio will contain further details on this introductory course.

ICAM is offering the following four IFRS courses as part of the fall/winter PD program:

- IFRS – Survey of the Standards - October 23 & 24, 2008
- IFRS – A Comparison to Canadian GAAP - January 21, 2009
- IFRS – Financial Statement Presentation - January 26, 2009
- IFRS - Focus on Property, Plant and Equipment - January 28, 2008

Also, the April 2008 edition of *CAMagazine* includes various articles regarding the transition process and key dates.

3. Financial Reporting for Private Enterprises

The AcSB, with the assistance of an Advisory Committee, is developing a set of financial reporting standards for use by all private enterprises regardless of size and, possibly, not-for-profit organizations. This set of standards will stand alone, in that an entity will not be required to refer to standards applicable to publicly accountable enterprises (i.e., IFRSs starting in 2011) and they will evolve over time.

The following approach is being used in the development of the private entity reporting standards:

- The existing CICA Handbook – Accounting will be used as a starting point;
- Certain existing Handbook Sections are irrelevant for private companies and will be excluded from the new set of standards. Such Sections are expected to include Section 1701, *Segment Disclosures*, Section 1751, *Interim Financial Statements*, and Section 3500, *Earnings Per Share*.
- The majority of the recognition and measurement standards in the existing Handbook, other than those that give rise to contentious issues, are relevant to the sector and will be retained with few, if any, modifications;
- Issues in the existing Handbook that have caused significant concern to private enterprises will be reconsidered, based on cost/benefit considerations. Problematic areas include: financial instruments, consolidation and accounting for affiliates, future income taxes, asset retirement obligations, employee future benefits, leases, current/non-current classification, goodwill and other intangibles, and share-based payments; and
- The specific disclosure requirements will be re-evaluated and are expected to be fewer than in the existing Handbook.

The AcSB announced on October 1st that private enterprises will NOT be required to apply current financial instruments standards, including Sections 1530, *Comprehensive Income*, 1651, *Foreign Currency Translation*, 3051, *Investments*, 3251, *Equity*, 3855, *Financial Instruments — Recognition and Measurement*, 3862, *Financial Instruments — Disclosures*, 3863, *Financial Instruments — Presentation*, and 3865, *Hedges*. Private enterprises may choose to apply the requirements of the XFI version of the Handbook (i.e. the standards in the Handbook prior to the issue of the revisions on financial instruments).

Additional decisions on financial reporting for private enterprises (including income taxes) can be found in the Decision Summary issued by the AcSB (http://www.acsbcanada.org/index.cfm/ci_id/46584/la_id/1.htm).

The AcSB has agreed to consider permitting not-for-profit organizations to apply the standards for private enterprises, together with additional standards addressing their unique circumstances. As such, the needs of these organizations will be considered in the development of the standards. It will remain the responsibility of the Not-for-Profit Organizations Advisory Committee to make recommendations to the AcSB on the suitability of the standards for the not-for-profit sector.

The Advisory Committee and the AcSB are working on a fast-track basis to develop the new set of standards. As they are developed, working drafts of the proposed individual standards are posted on the AcSB website. The expectation is that the working drafts will be completed by the end of 2008 and an Exposure Draft will be published during the first quarter of 2009.

Resources

Information on the objective, approach and timetable for the development of the new set of standards can be found on the AcSB website. In addition, a short video recording of a recent interview with Paul Cherry, AcSB Chair has been posted on the AcSB website. This interview specifically addresses the financial reporting standards being developed.

4. Financial Reporting for Not-for-profit Organizations

As noted above, the AcSB has agreed to consider permitting not-for-profit organizations to apply the standards developed for private enterprises, together with additional standards addressing unique characteristics of not-for-profit organizations.

In the interim, the AcSB has approved amendments to a number of Sections in the 4400 series that are intended to improve financial reporting by not-for-profit organizations and align the standards for these entities with standards applicable to profit-oriented enterprises when they address the same issues. The amendments include:

- enhanced disclosures relating to economic interest relationships;
- disclosure of allocated expenses;
- limiting the reporting of certain revenues net of expenses in the Statement of Operations;
- withdrawal of the requirement for net assets invested in capital assets to be reported as a separate component of net assets; and
- improved guidance related to the application of the GAAP hierarchy and capital assets standards, and requirements for not-for-profit organizations to apply the same standards as for-profit-oriented enterprises with respect to interim financial statements, statements of cash flows and disclosure of related party transactions.

These amendments are effective for fiscal years beginning on or after January 1, 2009 with early adoption encouraged.

5. **New and amended Handbook – Accounting Sections**

New and amended Handbook – Accounting Sections affecting many 2007 and 2008 financial statements are described below. A full listing of new and amended sections can be accessed on the AcSB website.

- **Financial Instruments - Disclosures**

Two Sections relating to financial instruments - Sections 3862, *Financial Instruments - Disclosures* and Section 3863, *Financial Instruments - Presentation* became effective for fiscal years beginning on or after October 1, 2007. The new Section on financial instrument disclosures places an increased emphasis on disclosures about risks associated with both recognized and unrecognized financial instruments and how these risks are managed. It removes duplicative disclosures and simplifies the disclosures regarding concentrations of risk, credit risk, liquidity risk and price risk that existed in Section 3861. The new Section on presentation of financial instruments carries forward the presentation requirements of Section 3861.

As noted in the section above regarding Financial Reporting for Private Enterprises, the current financial reporting standards relating to financial instruments will not be required for private enterprises.

In July 2008, Section 3855, Financial Instruments – Recognition and Measurement was amended to allow non-publicly accountable enterprises and not-for-profit organizations accounting policy choices on the recognition of non-financial contracts as derivatives and on the recognition of derivatives embedded in non-financial contracts, leases and insurance contracts. This amendment applies to interim and annual periods beginning on or after August 1, 2008 with earlier adoption encouraged.

Resources

Guidance on implementing the financial instrument standards can be found on the Financial Instruments Implementation Guidance project page on the AcSB website. The various support documents present a logical process for applying the standards. They also provide examples to illustrate the application of aspects of the standards to commonly encountered transactions.

ICAM is offering the seminar, "Accounting for Financial Instruments - Level 1" during the 2008-2009 Fall/Winter PD Program.

- **Capital Disclosures**

Section 1535, *Capital Disclosures* was issued in December 2006 and became effective for annual and interim periods beginning on or after October 1, 2007. Section 1535 requires entities to disclose their objectives, policies and processes for managing capital, as well as quantitative data about capital. The Section does not define capital; rather, it requires an entity to describe what it regards as capital. Section 1535 also requires the disclosure of any externally-imposed capital requirements, whether the entity has complied with them and, if not, the consequences.

In July 2008 the Section was amended to reduce the disclosure requirements for non-publicly accountable enterprises. Only non-publicly accountable enterprises with externally imposed capital requirements are required to disclose information that enables users of its financial statements to evaluate the effect of those requirements.

- **Inventories**

Section 3031, *Inventories*, replaced Section 3030, *Inventories* for fiscal years beginning on or after January 1, 2008. In general, the new standard:

- provides more extensive guidance on the determination of cost, including allocation of overheads;
- narrows the permitted cost formulas;
- requires impairment testing; and
- expands the disclosure requirements.

- **Going Concern**

In June 2007, Section 1400, *General Standards of Financial Statement Presentation*, was amended to include going concern requirements. The amendments require management to make an assessment of an entity's ability to continue as a going concern and to disclose material uncertainties related to events or conditions that may cast doubt upon the entity's ability to continue as a going concern. The amendments are applicable to all entities for fiscal years beginning on or after January 1, 2008 with early adoption encouraged.

- **Intangible Assets**

In November 2007, Section 3064, *Goodwill and Intangible Assets* was issued, replacing Section 3062, *Goodwill and Other Intangible Assets*, and 3450, *Research and Development Costs*. Section 3064 addresses the recognition, measurement, presentation and disclosure of goodwill and intangible assets and incorporates material from international standards regarding when an internally developed intangible asset meets the criteria for recognition as an asset. The changes are effective for fiscal years beginning on or after October 1, 2008, with early adoption encouraged.

There were various consequential amendments to Section 1000, *Financial Statement Concepts*, and Accounting Guideline AcG-11, *Enterprises in the Development Stage*. In addition, EIC 27, *Revenues and Expenditures during the Pre-operating Period*, will not apply to entities that have adopted Section 3064.