PASS

FINANCIAL ACCOUNTING ON THE CFE – AN INTEGRATED APPROACH

2017 CFE

INTRODUCTION

The first CFE was written in September 2015, the second CFE was written in May 2016 and the third CFE was written in September 2016. Therefore, students writing their CFE in Sept. 2017 will only have three CFEs that they can review in order to determine how financial accounting topics are tested on this Exam. (In fact, the May 2016 CFE did not publish a complete set of responses, but did publish Board of Examiner comments that students should review, to get an idea of the issues tested).

The good news however is that the ways in which various accounting topics are tested on the CFE is not appreciably different from the legacy UFE. The reason for this is that the CFE is also a case based exam which tests financial accounting at a high level and expects students to achieve depth in their responses. Also similar to the case of the UFE, the CFE also requires students to integrate financial accounting with the other competencies, although there is somewhat less integration on the CFE than there was on the UFE.

In light of the above, an analysis of how financial accounting topics were tested on the CFEs in 2015 and 2016 together with an analysis of how topics were tested on the UFE in years prior to 2015, provides a very useful guide, for how topics can be expected to be tested on future CFEs. This book provides a detailed summary of how financial accounting has been traditionally tested historically under IFRS and ASPE; it also addresses how topics may be tested in the future under both GAAPs. This will assist students in preparing for the Financial Reporting competency.

This book will help students to:

1. prioritize their studying, as they will be able to observe which topics have been tested heavily on past exams, as well as which aspects of a given topic tend to be examined in simulations; and

2. gain a solid understanding of how topics can potentially be tested on the CFE which will enable them to more effectively apply their technical knowledge in simulations that include financial accounting.

Structure of Booklet

The book is organized by accounting topic and covers all topics that have come up on the CFE in 2015 and 2016 and the UFE for the last 15 years.

Topics are broken down between major and minor topics. Major topics include those topics which meet any of the following criteria.

1. The topic has historically been tested reasonably frequently in the past.

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2. The topic can be expected to be tested in the future, even if there is not a lot of history of the topic being tested in the past.

3. The topic tends to be a major issue when it is tested, even if it is not tested that frequently.

Minor topics include those topics which either come up very infrequently or which tend to be minor issues when tested. Even if an issue comes up as a very major issue on an occasional exam (e.g. accounting for income taxes), it is classified in the minor topics section of the book, if it is tested very infrequently and is usually a minor issue.

Breakdown of Topics

For each topic discussed, the topic is broken down as follows:

1. Accounting Analysis

   An analysis is provided with regard to accounting issues which would comprise the following:

   A. Past testing of Topic:

      The way in which the topic has been tested in the past is discussed in detail.

      Also at the end of each section a table is provided which indicates when each topic was tested (e.g. 2015, Day 3, Simulation 3).

   B. Future testing under IFRS

      It should be noted that the history of testing under IFRS is not that long. IFRS has only been examinable for 7 years and initially only a fraction of IFRS standards were examinable. Therefore, there are still only a limited number of examples of UFE case scenarios that have been created with IFRS in mind.

      Past cases therefore provide only a limited number of scenarios that can arise on a UFE that are unique to IFRS. Accordingly, in addition to providing examples of how IFRS has been tested historically, where relevant, many examples are provided of how IFRS could potentially be tested in the future.

2. Integration

   There is a section on integration which discusses how the topic might be integrated with various other competencies. This is important, given that CFE simulations always test more than one competency, and therefore the ability to integrate financial

accounting with other competencies (and in particular assurance for those students who have chosen assurance as their depth area) is very critical.

Please note that in particular for Taxation some of the more complex examples of how tax was tested in the past would only be relevant to students who have chosen taxation as their depth area on the Elective/Role comp. This is due to the fact that for Day 3 of the CFE, topics can only be tested at the Core level, and at the Core level most of the advanced tax topics are either only examinable at level "C" or not at all. Students should refer to the CPA Competency Map Knowledge Supplement to determine whether a given tax topic is examinable at the Core level, as well as the level of depth at which examinable topics can be tested.

3. Summary

   A summary is provided of the cases in which the accounting topic has been tested over the last 15 years.

International Accounting Standards (IFRS) and Accounting Standards for Private Enterprises (ASPE)

For the 2017 CFE students are responsible for the full body of IFRS (Part 1 of Handbook) and ASPE (Part 2 of Handbook) and NPO Accounting (Part 3 of Handbook) within the limitations imposed by normal circumstances. Although as discussed above, this publication incorporates the GAAP that is currently examinable in its discussion of how topics have been and could be potentially tested on the CFE, it does not provide technical summaries of accounting standards.

There is, however, a separate PASS publication, *Financial Accounting Technical Review – 2017 CFE* which does provide a detailed technical summary of accounting standards and is specifically geared to the level of technical knowledge required for the CFE. This book cross references to certain sections of this PASS publication, in order to facilitate the study process. The PASS publication, *Financial Accounting Technical Review – 2017 CFE* is distributed at the PASS CFE Technical Accounting IFRS/ASPE Course and can also be purchased by visiting our website, www.passyourcpa.ca.

We hope you find this document useful in your studies. Almost all students have the potential to pass the CFE. It is merely a question of harnessing your skills and applying them in the right direction. We hope this document helps you in that process. We both wish you the best of luck on the CFE!

Michael Levi and Ira Walfish

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SECTION 1

MAJOR FINANCIAL ACCOUNTING TOPICS TESTED ON THE UFE OR CFE

ACCOUNTS RECEIVABLE

Testing of Accounts Receivables in Past/Future

- *Recoverability and bad debt allowance*

  From an accounting perspective, the issue of recoverability and bad debt allowance is often tested.

- *Recognize valuation of receivables is an issue*

  You may be expected to recognize that valuation of receivables is an issue from numerical information provided in the case. For example, if the allowance for doubtful accounts relative to the total receivables is lower in the current year than in the prior year, while there are greater problems re: collections in the current year (e.g., there are far more accounts more than 90 days overdue), you would be expected to question the valuation of receivables.

- *Reasonability of allowance*

  Occasionally, it will be apparent that management is coming up with an allowance in an arbitrary way. For example management simply takes a provision arbitrarily of 5% of receivables, although this does not represent actual experience. In one case, based on case facts, it was clear that based on actual experience the allowance should be less that the arbitrary provision; it would have been a mistake to assume that it is perfectly fine as the company is simply being conservative, since one can not arbitrarily understate an item in the name of conservatism.

  As a rule, it may make sense to use a general provision (e.g. X% of receivables) using an average based on percentages of loss experienced in dealing with accounts with small balances; however individual balances with large balances (and definitely those in excess of materiality) should be analyzed separately (to ensure that the general provision is applicable).

- *Consider reasonability of the provision*

  You may also be expected to recognize that a provision (or increased provision) for doubtful accounts is required, based upon the F/S. e.g. A/R is up by a lot more

than sales. In some instances you may be expected to combine the fact that A/R is up by more than sales with other qualitative information in order to recognize the need for an increase in the provision.

- *Discounting, classification and collectibility*

  In cases in which accounts receivable are collectible over a long period of time, may need to consider (i) whether to discount (ii) classification of all/part of receivable as long term asset and (iii) whether there is a collectibility issue in light of the fact that a large amount is not due for a long time. The classification of A/R could have a major impact on working capital ratio.

  Under IFRS, you are required to recognize a sale at FV. Therefore, if the proceeds will be collected over time, fair value measurement would require discounting the proceeds. This would result in the receivable also being discounted.

- *Collateral and writedown of receivable*

  You may also have to consider the issue of collateral, if the receivable is secured. If the value of the collateral has declined in value to an amount below the amount outstanding, you may have to consider a writedown of the receivable. However, if the payments on the receivable are being made on schedule and the receivable is likely to be fully repaid, then no writedown is necessary.

  Please note that a receivable meets the definition of a financial instrument. Further discussion of impairment of receivables is provided in the Section on Financial Instruments.

- *Consider if item is receivable or some other asset*

  There have been cases where you needed to consider whether an item was in fact a receivable or some other asset.

- *A/R tied in with revenue recognition*

  A/R issue may be intertwined with revenue recognition, as whether revenue recognized impacts recognition of receivable; for example, in cases in which collection or customer right of return is an issue, the question may be whether to recognize revenue and set up allowance vs. not recognizing revenue at all.

- *A/R tied in with subsequent events*

  Event may take place after year end which impacts collectibility of receivable (e.g. customer goes bankrupt). Will need to consider whether to disclose or adjust financial statements, depending upon whether condition existed at the period end. In the bankruptcy example would have to determine whether the situation that led to bankruptcy existed at year end.

Potential Testing of A/R in the Future under IFRS

This area would not be impacted very much under IFRS. There is, however, one significant situation that would be impacted and that is the situation in which a company sells its receivables.

Under IFRS there are very specific rules in the case where a company sells its receivables that would determine whether the sale should be treated as a sale for accounting purposes with the A/R removed from the balance sheet or whether the sale should be treated as secured financing. A case scenario could arise on the exam in which you need to determine whether the A/R should be derecognized or whether the proceeds of the sale should be treated as a liability. This is discussed in more detail in the Section on Financial Instruments.

(Under ASPE, asset securitization is only level C.)

Integration

Assurance

- *Risk, audit approach and procedures re receivables* – Receivables are often an important and risky item in the financial statements. An issue relating to receivables could be part of an audit simulation in which you need to discuss risk, audit approach and/or audit procedures.

- *Internal controls re sales and cash receipts* – May need to consider internal control system over sales and cash receipts; could impact control risk and approach.

- *Procedures re collectibility* – In dealing with procedures, assurance is very closely intertwined with the accounting e.g. if the accounting issue is collectibility of receivables, you will need to come up with a procedure to determine valuation of receivables e.g. examine the aging of the receivables, examine financial statements of customer from whom the receivable is owing to determine credit worthiness, look at subsequent receipts, look at history of bad debt writeoffs, consider security etc. May also need to consider the impact of consignment receivables from the perspective of the consignor (you should recognize that they are less risky as they are owned by consignor until goods are sold).

- *Procedures for existence* – You may also need to consider procedures for existence – e.g. confirmations, subsequent receipts, select sample of sales from general ledger and trace back to invoice and sales order etc.

- *Related party transactions* – Pay particular attention to related party transactions.

- *Sampling* – you may need to consider the adequacy of a sample; e.g. is the sample large enough; is it representative, should it have been selected statistically etc.

Taxation

- *Reserve for doubtful accounts* – Reserve allowed for doubtful accounts (taken back into income in following year – see par. 12(1)(d) of Tax Act).
- *Deduction for bad debts* – Also possible to take deduction for actual bad debt experience in the year not already provided for. (If bad debt is recovered in future year, would be taken into income then).
- *Reserve for amount not due* – Consider reserve for an amount not due until a later date under installment sale contract. (limited to a maximum of 3 years based on gross margin).
- *Section 22 election on transfer of A/R as part of a Section 85 rollover* - The purpose is to maintain the deductibility for future bad debts. If no section 22 election, future bad debts treated as capital loss.

Finance

- *Cash flow – receivables collection* – Improving receivables collection can improve cash flow.
- *Financing source – selling receivables* – Selling receivables is a financing source to be considered.
- *Value of receivables* – You may also have to consider the valuation of accounts/notes receivable in a situation in which you are making a business decision on the basis of the financial statements (e.g., whether to call a loan, acquire a company etc.). In such a case, your main concern is whether the amount reflected in the financial statements truly reflects the value of the receivables that will be collected and that the receivables will be collected on time. You may have to perform some analysis of the financial statements (e.g., compare growth of sales with increase in the receivables balance), as well as consider qualitative information, in assessing the value of the receivables.
- *Acquisition – collectibility of receivables* – In the case of an acquisition, collectibility of receivables will affect the strength of the company's financial statement, which could affect whether to make the acquisition, the value of the acquiree, and/or whether it will be necessary to inject cash into the acquiree etc.

CFES AND UFES IN WHICH ACCOUNTS RECEIVABLE TESTED

Year	Day/Simulation
2012	Day 3, Simulation 2
2009	Day 2, Simulation 3
2008	Day 3, Simulation 2 (combined with subsequent event issue)
2007	Comp (included in assurance assessment opportunity)
2005	Day 2, Simulation 1
2003	Comp

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SUMMARY OF KEY ISSUES TO FOCUS ON

Accounting

Recoverability and bad debt allowance – may tie in with subsequent event

Valuation of receivables

Reasonability of allowance

Discounting, classification and collectibility

Value of collateral

Sale of receivables under IFRS

Auditing

- **Risk, approach and procedures re receivables**
- **Internal controls re sales and cash receipts**
- **Procedures re collectibility**
- **Procedures for existence**
- **Related party transactions**

Taxation

- **Reserves for doubtful accounts**
- **Deduction for bad debts**

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- **Reserve for amount not due**
- **Section 22 election on transfer of receivables as part of a S85 rollover**

Finance

- **Improving cash flows through receivable collection**
- **Financing source – selling receivables**
- **Valuation of receivables**

CONTINGENCIES AND PROVISIONS

Under IFRS, this topic is covered under IAS 37 *PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS.* Under ASPE, it is covered under HB Section 3290 *Contingencies*. It should be noted however that IAS 37 has broader application than S3290 and would include in addition to the subjects included under S3290, provisions for post – closure remediation costs (what is referred to under ASPE as asset retirement obligation), restructuring costs and onerous contracts. Accordingly, accounting for ARO's is included in this section of the binder.

Testing of Topic in Past Exams

- *Usually not a very major issue*

  Topic comes up occasionally, but historically has not been a very major issue

- *Accrue vs. disclose*

  Key issue is whether to accrue vs. disclose based on the following condition**:**

Contingent Losses - ASPE

	Amount of Loss is Reasonably	
Probability of Loss	***Estimable***	***Not Estimable***
Likely*	Accrual (and Disclosure**) Required	Disclosure Required
Unlikely	Not required**	Not Required***
Not Determinable	Disclosure Required	Disclosure Required

* In the event that the case provides a percentage probability, an outcome that is greater than 70% probable, would be considered likely, in which case the liability (for the full amount of the claim) would be accrued. See rules for accrual under IFRS below.

** If there is potential exposure in excess of the amount accrued, it should be disclosed.

e.g. It is likely that the loss will amount to <u>at least</u> $1 million but it may amount to as much as $5 million; (i.e. it is not determinable whether or not it will amount to more than $1 million). In such case, under ASPE you would accrue $1 million and disclose the remaining exposure.

***Disclosure is desirable only if there could be a significant adverse effect on the entity.

In determining the amount to accrue one also needs to consider whether a likely loss to an enterprise may be reduced or avoided by a counterclaim or a claim against a third party. In such a case, the amount of the likely recovery is an element of the likely loss and, therefore, would be taken into account in determining the amount to be recognized in the income statement (i.e. the amount of the likely recovery can be netted against the amount that will likely have to be paid in determining the amount of the accrual). However, if the probability of success in the related action (e.g. a counter claim) is less than likely, a potential recovery would not be taken into account.

Contingent Gains - ASPE

	Amount of Gain is Reasonably	
Probability of Gain	***Estimable***	***Not Estimable***
Likely	Disclosure Required	Disclosure Required
Unlikely	---	---
Not Determinable	Not Required*	Not Required*

*Disclosure of the existence of the contingency may be desirable

The issue has come in which a company has recognized a contingent gain. For example, a company sells a faulty product and has an obligation to repair the product, but expects to collect damages from the supplier from which it sourced the product. You would be expected to realize that under ASPE the company needs to accrue the liability assuming it is reasonably estimable, but can not recognize the amount that they expect to collect in damages from the supplier, as that would constitute recognizing a contingent gain. However if recovery of damages is likely disclosure would be appropriate.

(Note that under IFRS, if recovery of the damages was "virtually certain" recognition of a "reimbursement asset" would be appropriate. On one past exam students were expected to recognize this difference between IFRS and ASPE. See below for further discussion of reimbursements under IFRS).

- *Asset retirement obligation*

  Issues that can arise include:

- Whether a liability needs to be set up. For example there must be a legal obligation associated with the retirement of an asset that an entity is required to settle as a result of a law, contract, or under the doctrine of promissory estoppel. Would usually relate to a capital asset but in one case it related to a stockpile of metal – ie inventory.
- Recognition that the accrual of the liability can only take place when management can estimate the expenditure to settle the obligation. Assuming this can be done, may need to accrue each year even if restoration costs will take place in a number of years, if the damage/depletion is taking place each year. (e.g. Each year that a nuclear facility is operated, contamination is being caused, so need to accrue each year).
- Need to add the amount accrued as a liability to the cost of the asset – as a result of adding the ARO to a depreciable asset, depreciation expense is increased; also as you are increasing the carrying value of the asset this could lead to an impairment if the CV exceeds the recoverable amount of the asset.
- Error in not accruing an ARO in connection with a past acquisition of PPE. Students are expected to recognize the error, realize that it should be corrected retroactively and then do the computations to determine what the balances would have been in the financial statements for both the ARO and PPE had the ARO been dealt with correctly under GAAP. This would involve computing the initial ARO at the time of the acquisition by discounting back the obligation and then computing the cumulative depreciation expense for the PPE and cumulative accretion for the ARO, since the date of acquisition.

MUST BE COMFORTABLE WITH THE NUMBER CRUCHING FOR ARO

The Term "asset retirement obligation" does not come up under IFRS but the principles would be the same with (just a couple of minor differences discussed below)

For example on one case based on IFRS, you needed to consider the appropriate treatment of decommissioning costs to restore land to its original condition and the above issues were present.

- *Warranty liability*

  Warranty liability can come up; may be necessary to recognize the need for a liability and/or consider the amount of the accrual that will be necessary. If you have to quantify the warranty provision it is very important to pay attention to case facts. E.g. what is covered, how long is the warranty for (i.e. 1 year or 2 years etc.)

On one case, for an in-depth discussion, students would have discussed more than one alternative for dealing with the accounting for the warranty. The entity was in the business of selling houses and was committed to doing warranty work free of charge over a two year period after selling a house. The alternatives were to recognize the full revenue on the sale of a house but accrue an expense for the work under warranty or defer the revenue associated with the warranty and recognize it over 2 years.

In considering a warranty provision under ASPE one could tie to tie back to the basic rules for contingencies under HB 3290 (although warranty provisions are not dealt with explicitly in this Section) – i.e. one would accrue the likely amount of the loss, with any remaining exposure disclosed.

- *Counter claim/insurance*

  A company is sued and you are given information with regard to a counter claim that company has issued against another company. You need to consider the likelihood of the counter claim succeeding as if it is likely to succeed then one can net the counter claim against the amount that the company being sued is likely to have to pay out in determining the accrual. On a recent CFE is where there was a a situation in which there was a lawsuit against a company and you needed to consider whether the company's insurance could be netted against the amount that would likely have to paid out in determining the accrual. In that case it was likely that a portion of the claim would be covered by insurance and it was therefore possible to subtract the insurance coverage from the likely payout for the lawsuit, in determining the accrual..

- *Could tie in with subsequent events*

  Contingencies could tie in with subsequent event, if for example a lawsuit came about after year-end.

- *Could tie in with correction of error*

  Would be the case if in error, an amount was not accrued. Remember that errors are corrected retroactively.

- *Could tie in with going concern*

  This issue could tie in with going concern issue; this issue alone does not often create a going concern issue; however, a contingent loss may be one factor in supporting a going concern issue.

- *Tie back to case facts*

As in the case of any area, important to tie back to case facts, rather than simply reciting conditions.

If the correct treatment is black and white (e.g. there is a contingent gain), do not waste time discussing alternatives; just apply the handbook guidance quickly and move on.

Past testing of topic under IFRS

Provisions

Need to recognize that a contingent liability that would be recognized under ASPE, would be referred to as "provision" under IFRS – i.e. difference in terminology.

Also under IAS 37, would accrue a provision when there is a lower likelihood of a cash outflow than would be required under ASPE, in order to accrue a contingent liability. That is under IFRS the outflow must be probable – meaning that only a probability of more than 50% is required to accrue a provision, while under ASPE an outflow would have to be "likely" (which connotes more than, say, 70% probability), before a contingent liability is accrued.

One of the conditions under IFRS for setting up a provision is that there is an obligation due to a past event. That is, an obligating event has taken place and nothing can be done to avoid the obligation. It is very important to use case facts to determine whether or not the obligating event can or can not be avoided.

Constructive Obligation

The issue of constructive obligation has also come up. In one case the company faced an environmental threat. Students would have been expected to consider whether a provision for site restoration costs should be recognized based on either legal obligation or past practice of settlement. In another case students needed to consider whether a bonus needed to be accrued in a situation where no legal obligation existed (given that the terms that would require payment of the bonus were not met), based upon a constructive obligation.

Contingent Asset versus Reimbursement

Students needed to consider whether to treat something as a reimbursement based on whether there was "virtual certainty" with regard to its realization. In one case it was a little tricky as the amount had been recorded as a prepaid, but the company was in effect treating it as a reimbursement. Another example of a

reimbursement is the situation where the company has insurance that is intended to reimburse the company for losses suffered.

If you determine that the virtual certainty condition has not been met and that the balance is a contingent asset rather than reimbursement, the next question that needs to be considered is disclosure of a contingent asset. Under IFRS, contingent assets are disclosed if it is "probable" that there will be an inflow of economic benefits. Therefore in dealing with disclosure, you would need to consider based on case facts if the "probable" condition has been met.

Future Testing of Contingencies and Provisions under IFRS

Scenarios that might be tested in the future would include:

- *Various issues re: provisions, reimbursements and contingent assets*

  A. Situations in which a range of possible outcomes is provided for establishing a provision. Students would be expected to know that if a best estimate can not be made, the mid point would be accrued – unlike ASPE where the minimum amount in the range would be accrued.
  B. A situation in which the potential reimbursement exceeds the provision (e.g. the amount claimed in a countersuit exceeds the amount the amount of the provision relating to the lawsuit). Would be important to realize that the amount set up for the reimbursement can not exceed the provision to which it relates.
  C. It is virtually certain that an asset will be realized (e.g. that a countersuit will be successful) but the precise amount that will be realized is not virtually certain. Would be expected to recognize that still possible to recognize asset as long as reliable estimate can be made.

- *Provision for post – closure remediation costs (what is referred to under ASPE as asset retirement obligation)*

  As discussed above, issues would be similar to ASPE in that the company would need to set up a liability which would be measured by discounting back the cost (i.e. cash outflows).

  Main differences under IFRS include the need to adjust estimated cash flows and discount rate to a current appropriate estimate. This differs from ASPE under which a discount rate would not be changed once obligation is established.

  Also, unlike ASPE, the growth in the liability due to passage of time (what is referred to as accretion expense under ASPE) would be treated as interest expense under IFRS. This could have an impact when for example a company is subject to a covenant based on an interest coverage ratio.

- *Restructuring costs*

  A great deal of guidance is provided with regard to setting up a provision for restructuring.

  Situation could come up in which a company is for example terminating a business operation, closing or relocating a business, selling of certain operations or doing a fundamental reorganization and this will result in future costs (e.g. re: terminating contracts, termination fees etc.)

  Students may be expected to ensure the requirements for recognition of a provision for restructuring have been met:

  i.e. (1) Entity has a detailed formal plan & (2) entity has raised a valid expectation in those affected that it will carry out the restructuring by (a) starting to implement that plan or (b) announcing its main features to those affected by it. It will be critical to tie back to case facts in applying these requirements.

- *Onerous contracts*

  An onerous contracts is a contract in which the unavoidable cost of meeting the contract exceeds the economic benefits to be received under it.

  In such case a provision would have to be recognized based on the lower of: (a) cost of fulfilling the contract and (b) compensation or penalties from failure to fulfill the contract.

  If this topic were to come up on a case you would likely not be directed to it. Rather, if the company has for example entered into a contract or purchase order and since that time, circumstances have changed (e.g. the costs of fulfilling the contract have risen), you would need to consider whether the company is likely to lose money, and if they will lose money, what amount needs to be accrued.

Integration

Assurance

- *Risk – Lawsuits* – When are several large, significant uncertainties confronting a business that raise specific risks. An example of a major uncertainty would be the outcome of pending lawsuits.

- *Procedures – legal council and management* - As contingencies often involve lawsuits, the most common points are: discuss lawsuit with management; and contact legal council to determine the likelihood of the lawsuit succeeding as well whether a reasonable estimate can be made of the potential losses.

- *Procedures – examine insurance policy* - Would also examine insurance policy to determine coverage of potential loss including the probability of insurance contract covering the cost (which could impact whether in the case of IFRS a reimbursement asset is set up and in the case of ASPE whether the insurance coverage can be offset against the amount of the claim in determining the amount of the accrual).

- For onerous contract would want to look at the contract and examine the terms. May also need to verify current costs for whatever the contract commits to. For example, if entity is committed to selling widgets for $100 per widget we may need to verify the current costs of sourcing the widgets in order to determine whether the contract is onerous and the amount that needs to be accrued. Therefore, for example, one might examine recent purchase invoices for the widgets.

- In the case of a restructuring, in order to accrue a provision if implementation has not yet begun, it is necessary that the main features have been announced before a provision is recognized. From an assurance perspective, we would want to examine the communication (e.g. there may be written or electronic evidence).

<u>Finance</u>

- *Tie in to projected cash flows* - A contingent liability/provision could impact a company's projected cash flow. If the loss is likely to occur, you would probably build it in to the projected cash flow; if it is not determinable whether it will occur, you should still take it into account qualitatively. For example, after calculating the net cash flow, you might comment that if the legal suit is successful cash flows would be further strained.

<u>Tax</u>

- *Deductibility* – Contingent liability generally not deductible for tax

- *Restructuring* – Could lead to various tax issues in terms of deductibility of costs; in cases where divisions are being sold – taxation of the disposal; in a reorganization could be tax impact – e.g. if legal entities are being amalgamated or sold

- *Unavoidable costs* - For onerous contracts the unavoidable costs would not be recognized until the costs are incurred

CFES AND UFES IN WHICH CONTINGENCIES AND PROVISIONS TESTED

CFE

Year	Day/Simulation
2016 S	Day 2, Elective Comp (2 AOs)

S – September 2016 CFE

Year	Day/Simulation
2014	Day 3, Simulation 2
2014	Day 3, Simulation 1
2014	Day 2, Simulation 2
2013	Day 2, Simulation 3
2012	Day 2, Simulation 3
2011	Comp
2011	Day 2, Simulation 3
2010	Day 2, Simulation 1
2009	Day 2, Simulation 1
2009	Day 3, Simulation 1 (ASPE and IFRS)
2007	Day 2, Simulation 1
2005	Day 2, Simulation 1
2002	Day 2, Simulation 3

SUMMARY OF KEY ISSUES TO FOCUS ON

Accounting

Accrual vs. disclose – rules different under IFRS vs. ASPE in terms of when to accrue and in some cases amount accrued

For IFRS has obligating event taken place

Contingent gains/assets – when to disclose

Setting up asset for reimbursement

Onerous contracts

Restructuring

Could tie in with subsequent events

Could tie in with going concern

Auditing

Procedures – discuss with legal council, management

-- Review insurance policy; review contract

Finance

Consider impact on projected cash flow

Tax

Contingent liabilities are generally not deductible