

**PASS**

**FINANCIAL  
ACCOUNTING ON  
THE CFE—AN  
INTEGRATED  
APPROACH**

**2026 CFE**

# INTRODUCTION

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When it comes to the *Financial Reporting* competency, the challenge that many students face is the tremendous amount of technical knowledge included in this competency. This publication summarizes how different accounting topics have been tested historically on the CFE under both **ASPE** and **IFRS** from the September **2015 CFE to the May 2025 CFE**. We also discuss how topics could potentially be tested in future CFEs, which is particularly useful for topics that have not been heavily tested in the past.

For each financial reporting topic, we discuss:

- Which past CFE cases tested the topic.
- How the topic has been tested.
- How we think the topic could be tested in the future. This is especially important for topics where GAAP has been modified in the recent past and therefore there are either no or limited examples of how the new GAAP has been tested.

This book will help you to:

- prioritize your studying, since you will be able to determine which topics have been **tested heavily** on past exams, as well as **which aspects** of a given topic tend to be examined in cases; and
- Gain a solid understanding of how topics can potentially be tested on the CFE which will enable you to more effectively **apply your technical knowledge** in cases that include financial reporting.

Although it stands to reason that heavier emphasis should be placed on recurring topics, you should review the competency map and be very familiar with all financial reporting topics that are examinable. In a given year, topics that were not tested in the past can unexpectedly appear on a CFE. For example, the statement of cash flows was only tested for the first time in 2024. Accounting for a defined pension plan was not tested until 2025.

## *Breakdown of Topics*

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

### **Accounting Analysis**

An analysis is provided of the accounting issues which would comprise the following:

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A. List of past CFE cases in which a given topic was tested

B. Past testing of topic:

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

C. Future testing of topic:

As mentioned above, in cases where there has been limited or no testing of a topic on past CFEs, examples are provided of how the topic could potentially be tested in the future.

### **Integration**

There is a section on integration which discusses how the accounting topic might be integrated with various other competencies. This is important, given that CFE cases 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.

### **International Act'g Standards (IFRS) and Act'g Standards for Private Enterprises (ASPE)**

For the 2026 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). Although 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 – 2026 CFE*, which provides technical summaries for all of the major accounting topics. This publication is also included in the *PASS CFE Technical Binder*, financial accounting tab. This publication should be read in conjunction with *the Financial Accounting Technical Review – 2026 CFE*, to facilitate the study process.

*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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# 1. Contingencies and Provisions

## CFEs in Which Topic Was Tested

Year	Day/Case
2024 S	Day 2 Case (combined with subsequent events issue)
2024 M	Day 2 Case
2023 S	Day 2 Case (combined with subsequent events issue)
2023 M	Day 3, Case 3
2021 S	Day 3, Case 2
2019	Day 2 Case
2018	Day 2 Case
2017	Day 2 Case
2016 S	Day 2 Case (2 AOs)
2016 M	Day 2 Case

M – May CFE

S – September CFE

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## How Topic Was Tested on Past CFEs

- *Accrue versus Disclose – ASPE*
  - You needed to consider whether to accrue versus disclose a contingency.
  - In order to achieve competent, it was necessary to first consider the definition of contingency and demonstrate based on case facts why the particular situation (e.g. a lawsuit against the company) met the definition.
  - It was then necessary to tie case facts back to the conditions that need to be met before a contingency needs to be accrued. That is, you needed to demonstrate whether:
    - (a) the contingent loss is likely to occur and
    - (b) the amount of the loss can be reasonably estimated.
  - If either of the conditions were not met it was important to discuss whether disclosure was required.
  - Although you could have also discussed the nature of the disclosure required, this

was not required for the purpose of achieving competent (i.e. it was only necessary at the competent with distinction level).

- A scenario that came up on one CFE was a situation where the conditions for accrual were met for only a portion of the exposure for potential loss. In that scenario it was important to explain that disclosure would be required for the amount of exposure in excess of the amount accrued.
- *Accrue versus Disclose – IFRS*
  - You needed to determine whether a provision should be accrued for a lawsuit.
  - It was then necessary to tie case facts back to the 3 conditions that need to be met before a provision is accrued. That is, you needed to demonstrate whether:
    - (a) the entity has a present obligation as a result of a past event
    - (b) it is a probable (i.e. greater than 50%) that an outflow will be required to settle the obligation
    - (c) A reliable estimate can be made of the amount of the obligation.
  - The case provided a range in connection with the amount that would have to be paid out and made it clear that there was a high probability that the high end of the range would have to be paid out. You were expected to realize (as per the PASS technical notes on *Provisions, Contingent Liabilities and Contingent Assets*) that “if a range exists, choose the most likely outcome or the expected value”.
- *Dealing with a range for the contingent loss - ASPE*
  - You were dealing with a lawsuit and told that the lawyers indicated that it is likely that there will be a payout of \$50K. You were also told that the plaintiff is seeking \$100K and that the company does not want to pay out more than \$15K.
  - You were expected to apply the guidance in HB Section 3290 which stipulates that when a particular amount within a range appears to be a better estimate than any other, that amount would be accrued.
  - Using common sense it should have been apparent that the figure provided by legal council is the best estimate.
  - On another CFE you were provided with a range regarding the payout but legal council did not indicate the most likely outcome. You were therefore expected to realize that in this situation, under ASPE it is appropriate to accrue the lowest amount in the range since no amount within the range is indicated as a better estimate than any other.
- *Lawsuit filed post year – combined with subsequent event issue*

- An employee who was terminated during the year, filed a lawsuit against the company post Y/E.
  - You needed to determine whether the lawsuit related to a condition present at year end (in which case adjustment to the F/S would be appropriate, assuming the conditions for accrual under 3290 *Contingencies* were met) or whether it related to a condition not present at Y/E in which case disclosure would be appropriate (even if the conditions under the HB Section 3290 for accrual were met).
  - Dealing with the issue involved asking yourself what is the event that triggered the lawsuit; you could then determine whether the lawsuit was triggered pre-yearend in which case the condition that gave rise to the lawsuit was present at year end.
- *Treatment of Contingent Gain - ASPE*
    - A company incurred a loss as a result of a payout made due to a fraud.
    - The bank indicated that there was a 75% chance that the company will recoup the full amount.
    - You were expected to recommend that the amount expected to recoup be treated as a contingent gain and be disclosed (rather than recognized in income).

(It should be noted that the treatment of a contingent gain is similar under **IFRS** except that under **IFRS** it is sufficient that the probability of recovery be “probable” – which means greater than 50% - in order to recognize a contingent gain. **ASPE** requires that the probability of recover be “likely” which means a higher level of probability than **IFRS** – say at least 70%)

- *Lawsuit Counter Claim - IFRS*
  - On one recent case, there was a lawsuit against the company and the company was assuming that it would be reimbursed by the party responsible for the problems that led to the lawsuit. You needed to consider whether the amount the company is expecting to be reimbursed qualifies as a “reimbursement” under IAS 37 and could therefore be recognized as an asset in the balance sheet. It was critical to explain that a reimbursement can be recognized in the financial statements only if it is “virtually certain” to be received. Using the case facts you were expected to demonstrate that virtual certainty did not exist.

(The issue of a company that has been sued filing a counter suit against another company has not yet come. If it did, the treatment would be as follows. You

would need to consider the likelihood of the counter claim succeeding, as if it is likely to succeed, in determining the amount to accrue, one can net the counter claim against the amount that the company being sued is likely to have to pay out. A similar situation would occur in a situation where insurance is likely to cover all or a portion of the cost of the claim. In such a case the likely insurance payout could be netted against the amount that will likely have to be paid out in determining the accrual.)

- *Acceptance of Claim by Insurance Company- ASPE*
  - A company had been sued and the insurance company accepted the claim and agreed to payout a portion of the claim
  - You were expected to realize that this does not constitute a contingency given that the insurance company has agreed to pay out the claim (i.e. it is not just likely that they will pay it).
  - Accordingly it is appropriate to set up a receivable in the B/S and a gain in the B/S for the amount to be received.
  - Had this scenario come up under **IFRS** the amount to be received from the insurance company would have been treated as a reimbursement.
  
- *Warranty Liability – IFRS*
  - In dealing with this topic it was critical to first discuss whether the HB Section that deals with revenue (i.e. **IFRS 15**) is relevant or whether the warranty should be accounted for under the Handbook section that deals with provisions, contingent liabilities and contingent assets (**IAS 37**).
  - In order to make this determination, you needed to consider that the warranty would only be accounted for under **IFRS 15** if at least one of the following conditions was met:
    - (a) The warranty is being sold separately and
    - (b) An additional service is being provided under the warranty.
  - In one case in which the topic of warranty came up, neither of these conditions was met so the rest of the analysis had to be based on the rules under **IAS 37**.
  - In order to achieve competent it was very important to recognize that IAS 37 is applicable and then determine whether the warranty constitutes a provision (i.e. a liability) or a contingent liability.
  - This involved tying back case facts to the definition of provisions – i.e. a liability of uncertain timing or amount – and then tying back to the criteria for accruing a provision. That involved considering based on case facts:

- (a) whether there is a present obligation based upon a past event;
  - (b) whether there is a probable outflow; and
  - (c) whether a reliable estimate of the liability can be made.
- In another case, IFRS 15 was applicable to the warranty. See the Section on Revenue Recognition for a discussion of the issue.

### **Number Crunching**

- You needed to calculate the amount of the provision (i.e. liability) that needed to be accrued based upon the best estimate of expenditures necessary to settle the obligation. Although in the case that came up on the CFE, it was **not** necessary to consider the time value of money in determining the amount of the provision (given that the outflows were over a fairly short period and the timing of the outflows was uncertain), you should be alert to the possibility of having to discount back cash flows.
- Also, in computing the adjustment that needed to be made to the financial statements for the accrual of the warranty, ideally you were expected to remember to back out the amount that had already been accrued for the warranty, although this was not necessary for achieving competent.

### ***Testing of Warranty Liability under ASPE***

Warranty liability has not yet come up under **ASPE**. If it were to come up you would simply apply the rules for contingencies and would **not** consider the possibility of applying the revenue Handbook Section (3400).

- ***Onerous Contracts - IFRS***
  - An onerous contract is a contract in which the unavoidable cost of meeting the contract exceeds the economic benefits to be received under it. On one CFE, you were expected to recognize that a particular contract was onerous and tie back case facts to the definition of onerous contracts in order to demonstrate this.  
You were then required to consider the criteria for accruing a provision for an onerous contract by considering the basic criteria for accruing a “provision” (discussed above).
  - Finally, you were expected to discuss the measurement of the provision which is based on “unavoidable costs (i.e. the lesser of the lower of the cost of fulfilling the contract or the amount of the fine/penalty arising from failure to fulfill it).

### **Number Crunching**

- On more than one case you were expected to calculate the amount to accrue. On one case the outflows required under the contract were over a reasonably long period of time so ideally you were expected to consider the time value of money in computing the amount to be accrued.
  - This involved making an assumption with regard to the discount rate. Although it was possible to achieve competent without discounting back the outflows, you should keep in mind that if this topic comes up again on another CFE it may not be possible to achieve competent without discounting if the cash flows are over a long period.
  - Therefore, you are best advised to discount cash flows unless they are expected to occur over a short period, and the impact of discounting is insignificant.
- ***Restructuring Provision – IFRS***
    - A situation came up in which there was a major change that was made in the management structure of a company, and you were expected to realize that this would qualify under the definition of restructuring in IAS 37.7.
    - It was important to tie back to the general recognition criteria for any provision (i.e. IAS 37.14) and integrate these criteria with the specific criteria relating to restructuring.
      - For the first recognition criterion – existence of a present obligation present obligation (*legal or constructive*) as a result of a past event- you needed to tie back the case facts to the specific criteria in 37.72 as to whether a *constructive obligation* exists in the context of restructuring.
      - It would have been a waste of time to memorize the criteria in 37.72 – what was important was to be aware that these criteria exist and know where to find them in the HB.
      - It was straightforward to tie back to the second recognition criterion – probable outflow of resources – as restructurings generally require an outflow.
      - It was also straightforward to tie back to the third recognition criterion – a reliable estimate can be made of the amount of the obligation, given that there was a detailed plan in place.

The final step after determining all 3 recognition criteria were met and that a provision could be recognized, was to determine which costs to include.

- You needed to remember the following rules from IAS 37.80 and .81.
  - Only **include direct expenditures** that are both (a) necessarily entailed by the restructuring; and (b) not associated with the ongoing activities of the

entity.

- Exclude: a) retraining or relocating continuing staff b) marketing and c) investment in new systems and distribution networks.
- Based on the above rules you needed to determine which of the costs provided should be included and which should not - along with explanations – and come up with an adjusting entry
- *Decommissioning Liability - IFRS*
  - *Accrual and measurement of liability* - You needed to discuss requirement to accrue a liability based on tying back to the basic rules for accruing a provision (as per IAS 37, paragraph 14) as well how to measure the liability (i.e. based upon the best estimate of the expenditure required to settle the obligation as of the balance sheet date). It was also important to point out that the liability needs to be present valued back using a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability.
  - *Treatment of related Asset* – You needed to explain that the amount of the decommissioning liability would be added to the related asset.
  - *Accretion/amortization* – You needed to explain that the increase in the carrying amount of the decommissioning liability over the course of the year should be recognized as an accretion expense. You also had to explain that the asset amount of the decommissioning liability must be amortized over estimated useful life of the asset.
  - *Future changes* – You could have discussed the fact that the best estimate would require reconsideration in each reporting period if for example, due to changes in the industry, the estimated cost of decommissioning changes.

### **Number Crunching**

- You needed to calculate the measurement of the liability taking into account the time value of money. You were not told explicitly what discount rate to use. You had to use judgement in coming up with a reasonable rate taking into account the company's incremental borrowing rate from the bank and then adding a reasonable risk premium.
- You needed to also calculate the accretion and amortization expenses.

### Comparison with ASPE

Had the same case scenario come up under **ASPE** the analysis would have been similar. The terminology would, however, have been different, as you would have discussed the accrual of the decommissioning liability in the context of an asset retirement obligation (ARO).

## How Topic May be Tested in the Future

- *Asset Retirement Obligation (ARO)*

As mentioned above, the same issues that came up for the decommissioning liability under **IFRS** could have come up in the context of an ARO. Additional issues that could come up in the future 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. ARO usually relates to a capital asset but it could potentially relate to other assets e.g. inventory.
- *Determining the timing for accruing the liability* – Accrual of the liability can only take place when management can estimate the expenditure to settle the obligation. In some instances the obligation is created as soon as the asset is constructed, so assuming that the expenditure to settle the obligation can be estimated at that time, an ARO would be accrued at the time of construction. In other instances, the damage may occur as the asset is used (e.g. each year that a nuclear facility is operated, contamination is being caused), in which case it would be appropriate to accrue the ARO over the life of the asset.
- *Adding the ARO accrued to the cost of the asset* – As you are increasing the carrying value of the asset you should be alert to the possibility of an impairment if the increased CV of the asset exceeds its recoverable amount.
- *Error in not accruing an ARO in connection with a past acquisition of PPE* – Students would be 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.

If ARO is tested on a future CFE, it is quite likely that numbers would be involved, so you must be comfortable with the number crunching for AROs.

- *Subsequent Events*
  - Contingencies could tie in with a subsequent event, if for example a lawsuit came about after year-end. In such a case you would need to consider the rules for subsequent events alongside the rules for contingencies.
- *Going Concern*
  - Contingencies could tie in with a going concern issue. Although contingent losses alone do not often create a going concern issue, a contingent loss may be one factor that supports a going concern issue.

### Contingencies – IFRS versus ASPE

There are some key differences between **IFRS** and **ASPE** that you will need to keep in mind when dealing with contingencies:



- The terminology is different. A contingent liability that would be recognized under **ASPE** as a liability, and would be referred to as a “**provision**” under **IFRS**. Under **IFRS** the term “**contingent liability**” is only used where disclosure rather than recognition is required.
- Under IAS 37, one would accrue a provision when there is a lower likelihood of a cash outflow than would be required under **ASPE**. That is, under **IFRS**, the outflow must be “probable”, meaning that only a probability of more than 50% is required to accrue a provision. Under **ASPE** an outflow would have to be “likely”, which connotes more than, say, a 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 cannot be avoided.
  - If there is only a possible obligation from a past event and/or the outflow is not probable and/or it is not possible to measure the liability, one would only disclose rather than recognize a liability.
- Under **IFRS** there need not be a legal obligation to accrue a provision as a “constructive obligation” would be sufficient.

## Integration

### Assurance

- *Risk* – When there are several large, significant uncertainties confronting a business, that increases risk. An example of a major uncertainty would be the outcome of pending lawsuits against the company.
- *Procedures – lawsuit* – As contingencies often involve lawsuits, the most common points are: discuss lawsuit with management; and contact legal council to confirm the likelihood of the lawsuit succeeding, as well whether a reasonable estimate can be made of the potential losses. Also confirm the date the lawsuit was filed (e.g., may have been after year end-end).

If the lawsuit was settled in court post year-end, review documents of the court proceedings and verify the conclusion re the amount owing and ensure that the appropriate amount was included in accrued liabilities at year-end (assuming that accrual of the lawsuit was required). If money has paid out (before the end of the audit) inspect the relevant bank statement to determine that payment was subsequently made.

Review the note disclosure (where relevant) to ensure that the disclosure details meet Handbook requirements.

- *Procedures – examine insurance policy* – You may need to examine an insurance policy to determine coverage of a potential loss including the probability of an 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).
- *Procedures – ARO/decommissioning liability* – You may need to verify government regulations/laws (e.g. from a government website) to ensure that there is an obligation (i.e. keeping in mind that an ARO/decommissioning liability emanates from a legal obligation). You also need to verify the measurement of the liability. In order to do so, you could for example:
  - Obtain management’s calculation of the liability and vouch the significant assumptions to supporting documentation (e.g. a supplier quote/contract for the current disposal cost)
  - Consider loan agreements for any liabilities that have similar risk profiles to the ARO/decommissioning liability recorded, to ensure a reasonable discount rate reflective of the risk involved was used
  - Re-calculate the liability to ensure it is correct

The ARO/decommissioning liability is normally added to the asset to which it relates. You will need to ensure that an appropriate useful life is used in calculating depreciation for that asset in order to verify depreciation expense. You may be able to determine that an appropriate useful life is being used by discussing the estimated useful life with management and evaluating any supporting documentation.

- *Procedures – onerous contracts* – For onerous contracts, you would need to look at the contract and examine the terms (e.g. the cancellation terms). You also may need to verify current costs for whatever the contract commits the company to doing. For example, if the 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 to verify the price at which the widgets the widgets can be acquired. One would also examine the contract to verify the \$100 selling price.

You may have a situation where the onerous contract results from the fact that the company has committed to purchasing a particular number of units over a period of time (which it requires for production or some other business use) and based on changes in the business, it will no longer require the number of units anticipated. You will need to consider the number of excess units that must be acquired under the contract that are no longer needed, in verifying the computation of the cost of fulfilling the contract.

As an auditor you would need to assess the reasonableness of the number of excess units. This will involve considering the reasonableness of the underlying assumptions used by the company to develop projections/forecasts of the number of units that will be required.

- *Procedures – restructuring*

To test the existence and appropriate classification of the restructuring costs as a provision, review the formal restructuring plan and details of expenditures to be made.

If implementation of the restructuring plan has not taken place before the end of the period, obtain evidence supporting the date of the obligation, such as the date of the announcement and the formal communication shared with employees (e.g. copies of emails or formal notices), to validate that the plan meets the criterion of a provision.

In relation to the classification assertion, obtain supporting documents (e.g. invoices, quotas, timesheets, contracts etc.) and review the nature of each type of expenditure to ensure that it qualifies to be included in the provision under IAS 37 – Remember that only direct costs necessarily entailed by the restructuring qualify.

To test the valuation of the restructuring provision, review the items that make up the

provision, and discuss with management the estimates used to determine the valuation of these expenditures. Also, assess the supporting documentation for the estimates for reasonability against any agreements or contracts (e.g. severance costs against actual payroll records and the severance agreement, support services for retraining terminated employees against contracts with third-party providers, etc.).

To test the occurrence of the restructuring expenses, inspect the expenses journal and trace to the invoice, supplier quote, or other supporting documentation. Review the dates on evidence obtained (e.g. invoices), to ensure proper cut-off.

### Management Accounting

- *Whether to cancel contract* - On one CFE in which the topic onerous contracts came up as a financial reporting topic, for one of the management accounting AOs, students needed to determine whether the company should cancel the contract and pay the cancellation cost. Both quantitative and qualitative analysis was required.
- *Reimbursement* – You needed to recalculate the amount of a claim for reimbursement as a result of a contractor not fully fulfilling its obligations. You needed to consider the amount of costs that directly related to the contractor underperforming under the contract, including consideration of whether costs were incremental.

### Finance

- *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.

### Tax

- *Deductibility* – A contingent liability is generally not deductible for tax purposes.
- *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.

- *Warranties* – Cannot be deducted until the cost is incurred.

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**End of Section**

## 2. Non-Current Assets Held for Sale and Discontinued Operations

### CFEs in Which Topic Was Tested

Year	Day/Case
2015	Day 2 Case – both topics: assets held for sale and discontinued operations were tested – very major

### How Topic Was Tested on Past CFEs

You were presented with a situation in which a company was planning to sell an operation.

In order to address this topic at the competent level it was critical to address the following:

- 1) Whether the operation qualifies as a “component”

This involved considering whether the operations and cash flows can be clearly distinguished operationally and for financial-reporting purposes from the rest of the enterprise.

- 2) Whether the “held for sale” criteria are met

This was important given that if an operation has not been sold by the end of the reporting period, one can only treat the operation as discontinued if the held for sale criteria are met.

There are a number of criteria that determine whether an operation qualifies as held for sale. It would have been most efficient to copy the criteria from the CPA Handbook and then tie back to as many criteria as possible. To be competent you would have had to tie back to most of the criteria.

It was important to come to a definitive conclusion on whether the operation qualifies as held for sale – this is a good example of a sub-conclusion – and then discuss the measurement of the operation (which is at the lower of carrying amount and fair value less costs to sell).

It should be noted that if the operation had been sold by year end, the held for sale criteria **would not have been relevant** in determining whether to treat the operation as discontinued.

3) Whether the criteria for presentation of discontinued operation are met.

This involved considering whether:

- (a) the operation is a separate major line of business or geographical area of operations; or
- (b) part of a single coordinated plan to dispose of a separate line of business or geographical area of operations; or
- (c) the operation is a subsidiary acquired exclusively with a review to resale.

In deciding whether condition (a) was met it was important to keep in mind that there is no specific percentage that must be met in determining whether an operation is a “major” line of business or geographical area of operations. Furthermore, there is no specific measure that must be used to gauge the significance of the operation relative to the overall entity. You therefore needed to use judgement to determine which measures were most relevant to use e.g. sales, income, assets etc. in determining whether the operation was “major”.

Finally, it was critical to conclude with regard to whether the operation qualified as discontinued – this is a final conclusion – and then discuss the presentation of a discontinued operation.

Although this topic came up in under IFRS the analysis would have been similar under **ASPE** as the 2 GAAPs are very similar when you are dealing with a disposal of an operation.

## How Topic May be Tested in the Future

- *Abandonment of Asset*

Company plans to abandon an asset/operation rather than sell it. You would be expected to realize that the asset/operation cannot be treated as held for sale.

- *Calculation of Amount to be Treated as Income From Discontinued*

You may need to determine the amount of income that qualifies as income from discontinued operations for presentation purposes. In determining this, remember that the figure should not include allocation of head office/corporate costs.

- *Assets Held for Distribution to Owners*

A significant difference between **IFRS** and **ASPE** is that the **IFRS** standard which deals

with assets held for sale also applies to a non-current asset (or disposal group) that is classified as **held for distribution to owners** acting in their capacity as owners, unlike the parallel **ASPE** standard which would not apply in this situation. Therefore, in a case based on **IFRS**, a student may need to consider whether an asset or group of assets needs to be classified as held for distribution.

The rules are similar to those used to determine whether to classify an asset as held for sale. The ramifications are very significant, as once the asset or group of assets is reclassified as held for distribution to owners, they would be measured at the lower of carrying value and fair value less costs to sell, with any write down to fair value less costs to sell, being recognized in profit and loss. This could have a significant impact on the balance sheet and statement of profit and loss.

### **Assets Held for Sale - IFRS versus ASPE**

A final point to keep in mind is that the scope of **IFRS** (in terms of the types of assets that could potentially be classified as held for sale) is broader than **ASPE**; therefore you may need to consider situations that call for reclassification under **IFRS** that would not be relevant under **ASPE** (e.g. a company is committed to a sale plan involving loss of control of a subsidiary or the sale of an equity accounted investment).

## **Integration**

### *Audit*

- *Risk* – Risk may be increased as the company is considering selling a component and there will be new users. There can also be risk associated with the classification of the operation of the discontinued operation (e.g. the company has a bias to classify the operation as discontinued because it is losing money) as well as in the computation of the results from discontinued operations. For example, the company overstates the costs that are included in the results of discontinued operations, by allocating corporate overhead costs to the discontinued operation, in order to overstate the income from continuing operations.
- *Procedures* – Conduct procedures to determine if conditions and criteria above are met for treatment as a discontinued operation and if relevant, whether criteria for assets held for sale are met.

In order to recognize assets as held for sale the HB stipulates that the appropriate level of management must be committed to a plan to sell the asset (or disposal group) and an active program to locate a buyer and complete the plan has been initiated.

The asset (or disposal group) must also be **available for immediate sale** in its **present condition**, must be actively marketed at a price reasonable in relation to fair

value and it should be expected that the sale will qualify for recognition as a completed sale within one year.

Use common sense and ask yourself what you could examine.

- *Procedures – board minutes* – For example, you could review board minutes which indicate approval of the plan and/or letter of intent to sell to corroborate management commitment to sell. There may be professional or marketing documents used to sell the asset (disposal group) available which indicate that an active program to sell was in place and that the asset (disposal group) was available for immediate sale. These documents may also indicate a proposed price at which the sale is to take place as well as provide an indication that the sale will take place within the year.
- *Procedures – fair value* – Once you know the offering price you may need to do work to verify the fair value of what is being sold. If it is a whole operation there may be a business valuation you can examine; if it is an individual asset such as a building you may be able to verify fair value, by for example, confirming fair value with a real estate agent who is familiar with real estate prices in the area in question.
- *Procedures – selling costs* – As assets (disposal groups) classified as held for sale are recorded at fair value less costs to sell, if the selling costs are material you will need to verify selling costs. You should review management’s estimate of selling costs for reasonableness. If selling costs have already been incurred you may be able to agree selling costs to invoices. Alternatively, if the company has contracted with another company to look after the sale for them, you may be able to examine the contract which may stipulate a fee.
- *Procedures – discontinued operations* – For discontinued operation (given that the operation must be a ‘component’) you should inquire of management how the operations of the company are conducted to determine whether the operation being disposed of is operationally distinct. You should also obtain internal reports to determine that the operation is distinct relative to other operations of the company, from a financial perspective.
- *Procedures – major line of business / geographical area* – To determine whether the operation is a major line of business or geographical area of operations, you can recalculate the sales (or some other figure that is an indication of the size of the operation) as a percentage of total sales for the company.
- *Procedures – costs* – Procedures should be done in connection with the costs included in the discontinued operation to ensure that all of the costs relate to the discontinued operation. You can test the costs by selecting a sample of costs included in the discontinued operation and examining support to test that the

costs relate to the discontinued operation. You will also need to ensure that corporate/head office costs were not allocated to the discontinued operation. You can examine journal entries to determine whether there are such allocations. If there is a bias to overstate the costs of the discontinued operation (which increases risk), tie back to this risk.

- *Procedures – disclosure* – You should ensure that assets and liabilities relating to the disposal group are separately disclosed in the balance sheet as held for sale (assuming that the discontinued operation was not disposed of before year end).
- *Procedures – net of income taxes* – You should ensure that results of the discontinued operation are net of income taxes relating to the discontinued operation. Also ensure that the income taxes were correctly calculated based on the pre-tax results of the discontinued operation.

## Finance

- *Determine/calculate if operation should be sold* – The finance required may involve determining/calculating whether an operation should be sold or the value at which it should be sold.

## Taxation

- *Tax issues relating to sale of a business* – May need to consider various issues relating to the sale of business.
- *Shares vs. assets* – If the operation was incorporated, there is the question of sale of assets vs. shares, (if there are losses, sale of shares may allow for the losses to be utilized by the buyer). Also, if shares are sold there will only be a capital gain, versus if assets are sold where there can be recapture on the sale of depreciable assets and regular business income on items such as inventory which could lead to more tax.
- *QSBC* – May also need to consider whether shares sold would be Qualifying Small Business Corporation Shares, which would be subject to the small business deduction.
- *Not incorporated, consider tax impact of sale of assets* – If the operation was not incorporated, you may need to consider the taxation of individual items disposed of.
- *Should business be incorporated before sale* – May also need to consider whether it would be beneficial to incorporate operation before the sale.

- *Same similar business in context of utilization of losses* – could be relevant in the case of an acquisition.
- *Discontinue business* – May be possible to deduct terminal loss.

### Strategy and Governance

- *Strategic perspective* – May need to consider whether an operation should be disposed of from a strategic perspective – i.e. tying back to the company’s strategy, objectives, mission etc.

[End of Section](#)

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