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Toronto Public Library Board

*2011 Year-end report
to the Board*

*Prepared as of
June 4, 2012*





June 4, 2012

The Board Members
Toronto Public Library Board

Dear Board Members:

We have substantially completed our audit of the financial statements of Toronto Public Library Board (the Library) prepared in accordance with Canadian generally acceptable accounting principles for the year ended December 31, 2011. We propose to issue an unqualified report on those financial statements, pending resolution of outstanding items outlined on page 1. Our draft auditor's report is included in Appendix A.

We have issued the accompanying report to assist you in your review of the financial statements. It includes an update on the status of our work, as well as a discussion on the significant accounting and financial reporting issues dealt with during the audit process.

We propose to review the key elements of this report at the upcoming meeting and discuss with you our key findings.

We would like to express our sincere thanks to the management and the staff of the Library who have assisted us in carrying out our work and we look forward to our meeting on June 25, 2012. Should you have any questions or concerns prior to the Board meeting, please do not hesitate to contact me in advance.

Yours very truly,

PricewaterhouseCoopers LLP

Terri McKinnon
Partner
Audit and Assurance Group

cc: Ms. Jane Pyper, City Librarian
Mr. Larry Hughsam, Director of Finance and Treasurer

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*PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

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The matters raised in this and other reports that will flow from the audit are only those that have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising and, in particular, we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted, as the report has not been prepared for, and is not intended for, any other purpose. Comments and conclusions should only be taken in context of the financial statements as a whole as we do not mean to express an opinion on any individual item or accounting estimate.

1. Executive summary

a. Status of the audit

We have substantially completed our audit of the 2011 financial statements (the financial statements). Our auditor's report will be issued once we receive and have completed our audit work on the outstanding items noted below.

This document includes the required communications between an auditor and Audit Committee, as required by Canadian generally accepted auditing standards (Canadian GAAS).

Our audit has been performed substantially in accordance with the plan and timeline previously communicated to you.

The following items will need to be completed/received prior to the issuance of our opinion. We will provide an update on the status of these items at our upcoming meeting.

Outstanding item	Status as at June 4, 2012
i. Receipt of signed management representation letter	
ii. Approval of the financial statements by the Board	

b. Key issues for discussion

Discussion item	Summary	For further reference
Items discussed with management	<ul style="list-style-type: none"> During the course of our work we discussed the following items with management: <ul style="list-style-type: none"> Management override of controls; Revenue recognition; and Voluntary separation program. 	Section 2
Summary of unadjusted items	<ul style="list-style-type: none"> As a result of our audit, we identified unadjusted items with an effect of \$195,000 understatement of surplus for the year. Unadjusted and adjusted items including disclosure exceptions or items not impacting net income are listed in section 3. In our opinion, the financial statements, taken as a whole, are free of material misstatement. 	Section 3
Fraud	<ul style="list-style-type: none"> No instances of fraud were noted as part of our audit procedures. We wish to reconfirm whether the Board Members are aware of any known, suspected or alleged incidents of fraud. 	Section 4
Management representations	<ul style="list-style-type: none"> Under Canadian GAAS, we are required to inform you of the representations we are requesting from management. A copy of the management representation letter is included in Appendix B. 	Appendix B

2. Significant audit, accounting and financial reporting matters

Preparation of the financial statements requires management to select accounting policies, as well as make critical accounting estimates and disclosures that may involve significant judgment and measurement uncertainty. These matters can significantly impact the Library's reported results.

We are responsible for discussing with the Board Members our views about the significant qualitative aspects of the Library's accounting practices, including accounting policies, the accounting estimates, and financial statement disclosures in accordance with the requirements of GAAP.

Our comments and views included in this report should only be taken in the context of the financial statements as a whole and are not meant to express an opinion on any individual item or accounting estimate. We are sharing our views with you to facilitate an open dialogue of these matters.

Risk Identified	Discussion
Management override of controls	<p>Significant estimates represent management's best estimates based on available information and are inherently risky due to their subjective nature.</p> <p>Management believes the appropriate level of controls over the segregation of duties exists, and these are supplemented by regular reviews.</p> <p>We have reviewed assumptions used by management in making significant estimates, and reviewed the nature and approval of manual journal entries. No significant exceptions or issues have been noted.</p> <p>We have performed unpredictable procedures during the audit. The exceptions noted are discussed in the internal control recommendations section (Section 5) of this report.</p>
Revenue recognition	<p>Revenues may be recognized in the wrong period, and donation revenues may be incomplete</p> <p>Management notes that government grants are supported by approved documents, which specify the period the funding relates to.</p> <p>The risk of incompleteness of donation revenues is minimal as the entire amount of donation revenue is from the Toronto Public Library Foundation.</p> <p>Other income consists primarily of rental revenue over properties rented out, are reconciled monthly and are agreed to the lease agreements for the period earned.</p> <p>PwC assessed the design and validated the operating effectiveness of certain revenue cycle controls. In addition, we performed substantive analytical procedures, and vouched significant grants to confirmations.</p>
Overstatement of accruals and expenses	<p>There is an inherent risk of overstatement of accruals and expenses to expend the budgeted funds received from the City of Toronto, and minimize the amount of unspent funds payable back to the City.</p> <p>We have performed a combination of controls and substantive testing over the appropriateness of expenses and accruals to ensure they are appropriate; they exist, have been included in the proper period, and have been properly approved.</p>

Risk Identified	Discussion
	<p>We noted a significant accrual was made for the Voluntary Separation Program (VSP). During the year, the Library accrued approximately \$7.2M for this program. The program provided voluntary separation packages to employees, while compensating them with up to 6 months of their salary, accrued vacation and sick pay.</p> <p>Application for the program was open to all employees, but only 112 were selected to participate. These 112 employees consist of a combination of full-time and part-time employees.</p> <p>Management accrued a liability of \$7.2M based on an estimate of each qualifying employee's current salary, accrued vacation and sick pay.</p> <p>We have reviewed management's estimates of the accrued liability by agreeing a sample of the participating employees' accrued payout to their employment file and the signed offer letters, and are in agreement with the amounts accrued. We noted the following 2 issues:</p> <ol style="list-style-type: none"> 1. There was an over accrual of vacation pay of approximately \$195K as the amounts owing to the employees participating in the VSP was double-counted in the VSP accrual and the regular vacation pay accrual. This amount was not adjusted in the financial statements and is reflected as an unadjusted item in Section 3(a) of this report. 2. There was an over accrual of approximately \$2M relating to sick pay for employees participating in the VSP as these amounts were also double-counted in the Employee Benefits liability, provided by Buck Consultants, as described below. This amount was adjusted in the financial statements, as is noted in Section 3b of this report.
Valuation of employee future benefits	<p>The Library relies on a third party valuation expert, Buck Consultants, to value to employee future benefits.</p> <p>We have obtained Buck Consultant's valuation report as of December 31, 2011 and have consulted with our internal actuarial group to ensure that the discount rates and significant assumptions used in their valuation conclusions are appropriate. As a result of our audit work, we concur that the assumptions used in the calculation of the employee future benefits are reasonable.</p>

3. Summary of unadjusted and adjusted items

We have concluded that the financial statements taken as a whole are free of material misstatement and (pending the completion, to our satisfaction, of the outstanding matters identified in section 1), we are prepared to issue an unqualified opinion on the financial statements.

Our responsibility is to issue an opinion as to whether the financial statements are free of material misstatement.

Under Canadian GAAS, we are required to communicate to you the unadjusted items and the effect that they may have on our opinion and to request that unadjusted items be corrected. As a result of our audit, we identified certain items and have discussed these with management, and management adjusted the financial statements to reflect certain of these items. Management has concluded that the remaining unadjusted items, which are described in (a) below, are immaterial individually and in the aggregate.

We are also required to communicate the effects of any unadjusted items that relate to prior periods. We did not note any such items.

a. Unadjusted items

The materiality level for December 31, 2011 was \$2,600,000 based on actual results. The materiality communicated in our audit plan based on forecasted results was \$2,432,800.

If all of the items (including differences in estimates) were adjusted, the following would be the effect on the Library's financial statements.

	Excess of revenue over expense	Statement of financial position		
Description	Over (under) stated \$	Assets (over) under stated \$	Liabilities over (under) stated \$	Net assets over (under) stated \$
<i>To reverse accrued vacation pay included in the VSP accrual</i>				
DR Accrued vacation and sick pay CR Staff costs	(195,000)		195,000	
<i>Presentation of interest expense</i>				
DR Interest Expense CR Operating Expense	96,000 (96,000)			
Total unadjusted differences	(195,000)		195,000	

b. Adjusted items

Adjustments made by the Library as part of the audit process are as follows:

Description	Excess of revenue over expense	Statement of financial position		
	Over (under) stated \$	Assets (over) under stated \$	Liabilities over (under) stated \$	Net assets over (under) stated \$
<i>Reclassification of revenue from the Partnership Opportunities Legacy Fund for the Malvern branch media labs, which was distributed by the City</i>				
DR Other income	1,150,000			
CR City of Toronto revenues	(1,150,000)			
<i>To reverse the sick pay benefits included in VSP accrual</i>				
DR Employee benefits			2,011,465	
CR Staff costs	(2,011,465)			
Total adjusted differences	(2,011,465)		2,011,465	

4. Other required communications

Canadian GAAS requires that the external auditor communicate certain matters to the Board Members that may assist you in overseeing management's financial reporting and disclosure process.

Below, we summarize these required communications as they apply to you:

Matter to be communicated	PwC's response
Management's representations	<ul style="list-style-type: none">• Under Canadian GAAS, we are required to inform you of the representations we are requesting from management. A copy of the management representation letter is included in Appendix B.
Significant deficiencies in internal control	<ul style="list-style-type: none">• Recent changes to Canadian GAAS require us to communicate to the Board Members internal control weaknesses identified as part of our audit that are considered to be significant deficiencies.• A significant deficiency is defined as an internal control deficiency that we consider merits the attention of the Board Members.• We did not note any significant deficiencies. However, we have noted a number of best practice recommendations in Section 5.
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none">• No difficulties or disagreements occurred while performing our audit that require the attention of the Board Members.
Fraud and illegal acts	<ul style="list-style-type: none">• No fraud came to our attention as a result of our audit procedures.

5. Internal control recommendations

The purpose of our audit was to enable us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

During our audit, we identified the following best practices and certain other control recommendations that we have discussed with management and wish to bring to your attention.

Control deficiencies – current year

Identified deficiency	Recommendation	Management's response
<p>Inconsistent review of payroll reports</p> <p>A manual review is performed between inputs to the service organization (Ceridian) and source documents to verify the completeness and accuracy of data provided. Differences and/or unusual items are investigated and resolved on a timely basis. Specifically for the Library, new hires/terminations/changes in salary/wage rates, are reviewed and approved.</p> <p>In the current year, we noted that the review and approval was missed on 2 of the samples we selected for inspection.</p>	<p>PwC recommends that every pay period, the journal entry should be approved by the Accounting Manager. As well, each exception report should be approved for accuracy and reasonableness.</p>	<p>Management agrees with our recommendation and has agreed to review journal entries and approve each exception report.</p>
<p>No approval for new vendors</p> <p>PwC noted that there is no formal approval process for the set up of new vendors.</p> <p>When a vendor needs to be set up in the system, there are two ways that accounting is notified:</p> <ol style="list-style-type: none"> 1) If a PO was required, purchasing will send accounting a copy of the PO with the purchaser's approval. Accounting will then set up the vendor into the system. 2) When a PO is not required, Accounting is notified (e.g. through a copy of the approved invoice) and the vendor is set up. 	<p>The Library should create a formal process for approving new vendors whereby departmental managers must complete a form which outlines all the necessary contact information, and reasons for setting up the new vendor, and sign the form as evidence of their approval. An accounts payable clerk should then verify the validity of the vendor prior to entering into the system</p>	<p>Management agrees with our recommendation and will implement an authorization policy whereby new vendors must be logged on a form, which will be reviewed and approved by the Purchasing Manager.</p>

Identified deficiency	Recommendation	Management's response
There is no review of the vendor information before the vendor is paid, which can enable employees to misappropriate assets by paying fictitious vendors.		

Control deficiencies – prior year

Identified deficiency	Recommendation	Management's response
<p>Supporting documentation for employee expense claims</p> <p>In the prior year, we noted during our testing of internal controls that in some instances, employee expense reports had been approved and reimbursed without the appropriate documentation supporting amounts claimed. Specifically, as allowed under the Library's expense claim policy, mileage can be claimed up to an amount equivalent to the least expensive alternative mode of transportation</p> <p>This presented an opportunity for employees to claim mileage without providing sufficient evidence of the lowest costing alternative mode of transportation.</p>	<p>PwC recommended the review and approval process for management expense reports be conducted in a more detailed manner. Expense claims with insufficient supporting documents should be returned to the employee with instruction to resubmit the expense report with all relevant supporting documentation.</p>	<p>Additional training was provided to staff who review and approve expense reports to ensure appropriate documentation is included with the expense report before reimbursement is made.</p> <p>PwC noted that this issue was resolved during the year, and does not continue to present a risk.</p>
<p>Lack of review of payroll expense reconciliation</p> <p>In the prior year, we noted that on a bi-weekly basis, the Payroll Officer prepares a manual reconciliation of the payroll information from the Ceridian payroll register as well as the journal entry to record the payroll in the general ledger. According to the Library's policy, the Accounting and Payroll Manager should be reviewing the journal entry prior to posting the entry. We noted that the journal entry was being reviewed by another Payroll Officer instead of the individual stated in the policy.</p>	<p>PwC recommended that the Library policy be adhered to, and that a payroll reconciliation be prepared at year end.</p>	<p>Management noted that a reconciliation was prepared at year end. PwC reviewed this reconciliation and concluded that this does not continue to present a risk.</p>

Appendix A: Draft financial statements

See Board Report. No. 23

Appendix B: Management representation letter

[Client Letterhead]

[Date]

PricewaterhouseCoopers LLP
5700 Yonge Street
Suite 1900
Toronto, ON M2M 4K7

Dear Sirs:

We are providing this letter in connection with your audit of the financial statements of Toronto Public Library Board (the Board) as of December 31, 2011 and for the years then ended for the purpose of expressing an opinion as to whether such financial statements present fairly, in all material respects, the financial position, the results of operations and the cash flows of the Board in accordance with Canadian public sector accounting standards.

Management's responsibilities

We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated November 1, 2010. In particular, we confirm to you that:

- We are responsible for the preparation and fair presentation of the financial statements in accordance with Canadian public sector accounting standards;
- We are responsible for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. In this regard, we are responsible for establishing policies and procedures that pertain to the maintenance of accounting systems and records, the authorization of receipts and disbursements, the safeguarding of assets and for reporting financial information in accordance with Canadian public sector accounting standards;
- We have provided you with all relevant information and access, as agreed in the terms of the audit engagement; and
- All transactions have been recorded in the accounting records and are reflected in the financial statements.

We confirm the following representations:

Preparation of financial statements

The financial statements include all disclosures necessary for fair presentation in accordance with Canadian public sector accounting standards and disclosures otherwise required to be included therein by the laws and regulations to which the Board is subject.

We have appropriately reconciled our books and records (e.g. general ledger accounts) underlying the financial statements to their related supporting information (e.g. sub ledger or third party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to an operations account and vice versa. All inter-governmental unit accounts have been eliminated or appropriately measured and considered for disclosure in the financial statements.

Accounting policies

We confirm that we have reviewed the Board's accounting policies and, having regard to the possible alternative policies, our selection and application of accounting policies and estimation techniques used for the preparation and presentation of the financial statements is appropriate in the Board's particular circumstances to present fairly in all material respects its financial position, results of operations and cash flows in accordance with Canadian public sector accounting standards.

Internal controls over financial reporting

We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Board is made known to us by others.

We have designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian public sector accounting standards.

We have disclosed to you all deficiencies in the design or operation of disclosure controls and procedures and internal control over financial reporting that we are aware as of December 31, 2011.

Disclosure of information

We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters including:
 - Contracts and related data;
 - Information regarding significant transactions and arrangements that are outside of the normal course of business;
 - Minutes of the meetings of management, directors and committees of directors. The most recent meetings held was the Board meeting on September 13, 2011;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

Completeness of transactions

All contractual arrangements entered into by the Board with third parties have been properly reflected in the accounting records or/and, where material (or potentially material) to the financial statements, have been disclosed to you. We have complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.

Fraud

We have disclosed to you:

- The results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- All information in relation to fraud or suspected fraud of which we are aware affecting the Board involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements; and
- All information in relation to any allegations of fraud, or suspected fraud, affecting the Board's financial statements, communicated by employees, former employees, analysts, regulators or others.

Compliance with laws and regulations

We have disclosed to you all aspects of laws, regulations and contractual agreements that may affect the financial statements, including actual or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

We are not aware of any illegal or possibly illegal acts committed by the Board's directors, officers or employees acting on the Board's behalf.

Accounting estimates and fair value measurements

Significant assumptions used by the Board in making accounting estimates, including fair value accounting estimates, are reasonable.

For recorded or disclosed amounts in the financial statements that incorporate fair value measurements, we confirm that:

- The measurement methods are appropriate and consistently applied;
- The significant assumptions used in determining fair value measurements represent our best estimates, are reasonable and have been consistently applied;
- No subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements; and
- The significant assumptions used in determining fair value measurements are consistent with the Board's planned courses of action. We have no plans or intentions that have not been disclosed to you, which may materially affect the recorded or disclosed fair values of assets or liabilities.

Significant estimates and measurement uncertainties known to management that are required to be disclosed in accordance with The Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting Handbook Section PS 2130, Measurement Uncertainty have been appropriately disclosed.

Related parties

We confirm the completeness of information provided to you regarding the identification of related parties as defined by CAS 550 – Related Parties. We also confirm the completeness of information provided to you regarding the nature of the Board's relationships with and transactions involving those entities.

The list of related parties attached to this letter as Appendix B accurately and completely describes the Board's related parties and the relationships with such parties.

The identity and relationship of balances and transactions with related parties have been properly recorded and adequately disclosed in the financial statements, as required by Canadian generally accepted accounting principles.

Going concern

We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements (e.g. to dispose of the entity or to cease operations).

Assets and liabilities

We have satisfactory title or control over all assets. All liens or encumbrances on the Board's assets and assets pledged as collateral.

Receivables recorded in the financial statements represent bona fide claims against debtors for sales or other charges arising on or before the statement of financial position date and are not subject to discount except for normal cash discounts. Receivables classified as current do not include any material amounts that are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.

We have recorded or disclosed, as appropriate, all liabilities, in accordance with Canadian public sector accounting standards. All liabilities and contingencies, including those associated with guarantees, have been disclosed to you and are appropriately reflected in the financial statements.

Litigation and claims

All known actual or possible litigation and claims, which existed at the statement of financial position date or exist now, have been disclosed to you and accounted for and disclosed in accordance with Canadian public sector accounting standards, whether or not they have been discussed with legal counsel.

Misstatements detected during the audit

Certain representations in this letter are described as being limited to those matters that are material. Items are also considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm that the financial statements are free of material misstatements, including omissions.

The effects of the uncorrected misstatements in the financial statements, as summarized in the accompanying schedule (Appendix B), are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. We confirm that we are not aware of any uncorrected misstatements other than those included in Appendix B.

The adjusted misstatements identified during your audit and summarized in the attached table (Appendix C) have been approved by us and adjusted in the financial statements.

Events after balance sheet date

We have identified all events that occurred between the statement of financial position date and the date of this letter that may require adjustment of, or disclosure in, the financial statements, and have effected such adjustment or disclosure.

Yours truly,

Toronto Public Library Board

Wayne Lam, Manager of Accounting

Larry Hughsam, Director of Finance and Treasurer

Jane Pyper, City Librarian

Appendix A – List of related parties

City of Toronto
Toronto Public Library Foundation

Appendix B – Summary of Uncorrected Misstatements (SUM)

	Excess of revenue over expense	Statement of financial position		
Description	Over (under) stated \$	Assets (over) under stated \$	Liabilities over (under) stated \$	Net assets over (under) stated \$
<i>To reverse accrued vacation pay included in the VSP accrual</i>				
DR Accrued vacation and sick pay CR Staff costs	(195,000)		195,000	
<i>Presentation of interest expense</i>				
DR Interest Expense CR Operating Expense	96,000 (96,000)			
Total unadjusted differences	(195,000)		195,000	

Appendix C – Summary of Adjusted Misstatements (SAM)

Adjustments made by the Library as part of the audit process are as follows:

	Excess of revenue over expense	Statement of financial position		
Description	Over (under) stated \$	Assets (over) under stated \$	Liabilities over (under) stated \$	Net assets over (under) stated \$
<i>Reclassification of revenue from the Partnership Opportunities Legacy Fund for the Malvern branch media labs, which was distributed by the City</i>				
DR Other income	1,150,000			
CR City of Toronto revenues	(1,150,000)			
<i>To reverse the sick pay benefits included in VSP accrual</i>				
DR Employee benefits			2,011,465	
CR Staff costs	(2,011,465)			
Total adjusted differences	(2,011,465)		2,011,465	

Appendix C: Independence letter



June 4, 2012

The Board Members
Toronto Public Library Board
789 Yonge Street
Toronto, ON M4W 2G8

Dear Board Members

We have been engaged to audit the financial statements of the Toronto Public Library Board (the Board) for the year ended December 31, 2011.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the Board, its management and us that may reasonably be thought to bear on our independence.

In determining which relationships to report, these standards require us to consider relevant rules and related interpretations prescribed by the Canadian Institute of Chartered Accountants of Ontario and applicable legislation, covering such matters as:

- (a) holding a financial interest, either directly or indirectly, in a client;
- (b) serving as an officer or director of a client;
- (c) performance of management functions for an assurance client;
- (d) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client or its management;
- (e) economic dependence on a client;
- (f) long association of senior personnel with a listed entity audit client;
- (g) board members approval of services to a listed entity audit client; and
- (h) provision of services in addition to the audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters arising since May 2, 2011, the date of our last letter.

We are not aware of any relationships between the Board or its management and PricewaterhouseCoopers LLP that may reasonably be thought to bear on our independence that have occurred from May 2, 2011 and June 4, 2012.

We hereby confirm that we are independent with respect to the Board within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of June 4, 2012.

PricewaterhouseCoopers LLP, Chartered Accountants
North American Centre, 5700 Yonge Street, Suite 1900, North York, Ontario, Canada M2M 4K7
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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.



This report is intended solely for the use of the Board Members, management, and others within the Board and should not be used for any other purposes.

Yours very truly,

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Appendix D: Financial reporting update

Keeping you informed

Changes in financial reporting
requirements for Canada's
not-for-profit organizations



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Changes in financial reporting requirements for Canada's not-for-profit organizations

In December 2010, the Canadian Accounting Standards Board issued new accounting standards for not-for-profit organizations (NPOs) and changes for government not-for-profit organizations (GNPOs).

Under the previous approach, both GNPOs and non-government NPOs were directed to follow the Canadian Institute of Chartered Accountants' (CICA) Handbook, which includes standards developed to deal with the unique circumstances of many NPOs — the 4400 series. The new accounting framework will now be dependent on your organization's classification as either an NPO or GNPO.

To determine which standards to follow under the new framework, it's

important to understand whether or not your organization is controlled by a government body. The Public Sector Accounting (PSA) Handbook section 1300 provides guidance on the interpretation and application of the concept of government control. In some instances it may not be readily apparent whether government control exists, especially when an organization receives government funding indirectly or from a number of government bodies. As a result, NPOs should have a careful understanding of their particular facts and circumstances.

Once you've determined whether your organization is a government or non-government NPO, you will be required to adopt the appropriate standards for fiscal years beginning on or after January 1, 2012. The standards may have a significant impact on the financial reporting for your organization. We encourage both NPOs and GNPOs to consider the potential impact of the new standard and the appropriate time frame for adoption, as early adoption is permitted.



Understanding the new framework

The following table summarizes the key distinction in the new framework:

Definition	Existing Canadian Generally Accepted Accounting Principles (GAAP)	New Canadian Generally Accepted Accounting Principles
Non-government not-for-profit organizations Organizations that are not controlled by the government and that are organized and operated exclusively for social, educational, professional, religious, charitable or any other NPO purposes. Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.	Former CICA Handbook, including CICA 4400 Series (standards that apply only to NPOs)	Choice between: a. Part I of the CICA Handbook – International Financial Reporting Standards (IFRS) b. Part III of the CICA Handbook – Accounting Standards for Not-For-Profit Organizations (based largely upon Part II of the CICA Handbook – Accounting Standards for Private Entities, plus CICA 4400 Series)
Government not-for-profit organizations Organizations controlled by the government that have counterparts outside the public sector and that are organized and operated exclusively for social, educational, professional, religious, charitable or any other NPO purposes. Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization. Under the current definition, schools, hospitals, colleges and universities typically fall under this category.	Former CICA Handbook, including CICA 4400 Series	Choice between: a. PSA Handbook b. PSA Handbook supplemented by CICA 4400 series for NPOs which have been incorporated into the PSA Handbook as PS4200

Potential impacts of adopting Part III of the CICA Handbook – Accounting Standards for Not-For-Profit Organizations

It is expected that the majority of non-government NPOs in Canada will adopt Part III of the CICA Handbook. While for many organizations, this will not result in any significant accounting or disclosure changes, for others the implications may be more significant. The potential accounting and disclosure differences for NPOs that elect to adopt Part III of the Handbook include:

Accounting

- **Intangible assets** – A new intangible assets section reaffirms the applicability of section 3064 Goodwill and intangible assets, unless provided otherwise in the new section. Organizations are directed to consider the service potential of an intangible asset when assessing the existence of an impairment.
- **Financial instruments.**
 - The disappearance of the “available for sale” option means that organizations will no longer have the option to recognize unrealized gains and losses in the statement of changes in net assets/fund balances. Going forward, all changes in the fair value of the financial instruments will be recognized in the statement of operations.
 - All financial instruments can be carried at fair value if the option is selected on initial recognition. If not, the default treatment for quoted debt securities will be cost or amortized cost. For quoted equity securities, it will continue to be fair value. This creates a different default accounting treatment for investments depending on their nature.

- **Transaction costs** – Transaction costs incurred to acquire or issue financial instruments measured at amortized cost will be required to be netted against the carrying value rather than being expensed.
 - **Defined benefit plans** – For organizations with a defined benefit plan, there will be an option to select between the “immediate recognition approach”, where actuarial gains or losses would be recognized immediately in the statement of operations each period, or the “deferral and amortization approach”.
 - **Capital assets** – On transition to these standards, the organization may measure any individual capital asset at fair value and then use that fair value as its deemed cost at that date.
- Presentation and disclosure**
- **Primary Generally Accepted Accounting Principles** – Various items have been eliminated from the primary principles including Emerging Issues Committee (EIC) abstracts, background information, basis of conclusion documents, illustrative material and implementation guides.
 - **Cash flow statements** – All organizations must prepare and present a cash flow statement. There is no longer the option to omit the cash flow statement if the required cash flow information is readily apparent from other financial statements or note disclosures.
 - **Government remittances** – Government remittances payable that are outstanding at the balance sheet date are required to be disclosed and include federal and provincial sales tax, payroll taxes, health taxes and workers' safety insurance premiums among other items.
 - **Measurement uncertainty** – A description of the circumstances giving rise to the uncertainty and relevant information about the anticipated resolution of the uncertainty is required. Previously only the nature of material uncertainties was required to be disclosed.
 - **Presentation of investments** – Investments are classified as current only when reasonably prompt liquidation is possible.
 - **Non-classified balance sheet** – The balance sheet is segregated into current or non-current categories unless the entity operates in an industry where doing so is not appropriate.
 - **Capital disclosures** – The requirement to disclose the organization's policy and capital restrictions has been eliminated.
 - **Inventory** – No significant changes other than a reduction in disclosures – for example, there is no longer the requirement to have specific disclosures around impairments or reversals.

***Potential impacts of adopting
Part I of the CICA Handbook –
International Financial Reporting
Standards***

The option to adopt International Financial Reporting Standards (IFRS) is available to all non-government NPOs but will likely initially only be considered by those organizations that:

- Are part of a global organization whose affiliates have chosen to use IFRS;
- Participate in an industry with for-profit companies who report under IFRS; or
- Have international funders or other users of the financial statements who require the use of IFRS.

IFRS was originally developed for use in the for-profit world and does not contain specific guidance for NPOs. In addition, there is currently no intention to modify IFRS for NPOs; these organizations will be subject to the same standards and requirements as publicly accountable entities. Some of the most significant accounting and reporting implications of adopting IFRS include:

Accounting

- **Revenue recognition** – Under IFRS, there are no specific standards to address the unique nature of contribution revenue for NPOs. This specifically impacts the recognition of contributions restricted for specific purposes or time periods as well as endowment contributions that currently have specific recognition criteria under Canadian Generally Accepted Accounting Principles. Under IFRS, revenue is recognized under a general revenue recognition standard that may result in timing differences for recognition of contributions.
- **Property and equipment** – IFRS permits an entity to revalue property and equipment to fair value on the date of transition to the new accounting framework. If a NPO has investment property, it may also be carried at fair value and revalued annually to determine any fair value adjustments. Annual assessments for impairment of property and equipment must be made and impairment losses recovering in future periods can be reversed and recorded in the financial records.
- **Consolidation** – Current Canadian accounting standards provide NPOs with various alternatives to report controlled and related entities. Under IFRS, no similar standard exists, so accounting for controlled and related entities would follow general consolidation standards. This would result in the consolidation of all controlled entities and equity accounting for all entities in which a NPO has significant influence. Cost accounting would be used for those investments that a NPO does not control or have significant influence.

- **Employee future benefits** – While the standards around employee future benefits are similar to current Canadian GAAP, there are some differences that could result in how employee future benefits are recognized under IFRS. These primarily relate to the immediate recognition of past service costs and the planned elimination of the ability to smooth the recognition of actuarial gains and losses over time periods.
- **Capital leases** – Under current IFRS standards, accounting for leases is similar to Canadian GAAP. However, the specific tests to determine if a lease is capital in nature are slightly different, which may result in a different conclusion under IFRS. Organizations should also be aware that there is a current IFRS exposure draft on leases that could significantly change how leases are accounted for, including the potential recognition of all leases, operating and capital, on the balance sheet.

Presentation and disclosure

- **General financial statement presentation and fund accounting** – IFRS does not have an equivalent standard to Handbook Series 4400. As a result, the concept of fund accounting and the presentation of separate funds in the financial statements does not exist under IFRS. Related statements, such as the statement of changes in net assets, are replaced with IFRS statements, and would include a statement of comprehensive income.

- **Financial statement notes** – Under IFRS, note disclosure is generally more extensive, with detailed note requirements for specific accounts and balances. For example, disclosure of the compensation of key management personnel is required under IFRS in the notes to the financial statements. As well, because many NPOs have previously taken advantage of the exemptions available under Canadian GAAP to limit disclosures around financial instruments, additional disclosures will likely be required in this area.

Potential impacts of adopting the PSA Handbook

The status quo will no longer be an option for GNPOs as the PSA Handbook guidance differs from the CICA Handbook. Some of the more significant differences include:

Accounting

- **Pension plans** – Neither the corridor approach nor full recognition of actuarial gains and losses are allowed – all actuarial gains and losses are amortized over the average remaining service life of the employee group. There are other changes in the calculation methodology including the discount rate and a requirement to recognize plan amendments immediately.
- **Other employee future benefits** – Leave benefits, such as sick pay, are accrued under the PSA Handbook regardless of vesting provisions.
- **Intangibles** – Other than software, intangibles are not recognized as assets. Goodwill is rarely capitalized, but rather expensed in the period of acquisition.

- **Financial instruments** – A new standard was released in June 2011 and it is simpler than the former CICA Handbook equivalent. Fair value measurement is used only for derivatives and portfolio investments quoted in an active market. Hedge accounting is not permitted, however, with the new statement of remeasurement gains and losses (see below), organizations effectively benefit from similar treatment in that unrealized fair value gains and losses are not recorded in the statement of operations.

Presentation and disclosure

- If an NPO elects to adopt the PSA Handbook including the 4200 series of standards, the financial statements will be largely unchanged. However due to the new standard for financial instruments, there is a new statement called the statement of remeasurement gains and losses. Unrealized fair value gains and losses are reported in this statement.
- If an organization elects to adopt the PSA Handbook excluding sections 4200 to 4270, there will be numerous differences in presentation with respect to the primary statements. For example, statement of financial position classifications will now include financial and non-financial assets. The statement of operations will include budget information, and a statement of changes in net debt will be required.

Organizations converting to the PSA Handbook will need to identify the differences in the standards that impact them and quantify these differences. In addition, the PSA Handbook contains specific exemptions and exceptions applicable to the first time adoption of PSA Standards by government organizations.

Next steps

Organizations are required to transition to the appropriate standards by the fiscal year beginning on or after January 1, 2012, although early adoption is permitted. Now is the time to consider the options available and start to think about the appropriate implementation date of the new standards for your organization. Our team understands the new framework and is ready to help you through the process.

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