

WIP Issues for Management

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WIP ISSUES FOR MANAGEMENT

WHAT IS WIP?

Work in Progress (or WIP) is a taxpayer's partially finished goods waiting for completion and eventual sale or the value of those goods. In the context of a widget factory, the year-end balance sheet of the tax payer would account for the work in progress of any widgets that were partially built and awaiting completion. In the context of a professional firm such as a law office, the work in progress would likely include any billable hours recorded but not yet billed, or any other inputs on an open but unbilled file.

Section 10(1) of the *Income Tax Act* deals with the valuation of inventory and Section 10(4) and 10(5) deals with the inclusion of work in progress as inventory.

Section 34(a) of the *Income Tax Act* states that in computing the income of a taxpayer for a taxation year from a business that is the professional practice of...a lawyer... the following rules apply:

- (a) ... there shall not be included any amount in respect of work in progress...

Accordingly, up to the tax year ending 2017 most professionals have not used the full accrual accounting method, and have instead elected to exclude WIP.

In March of 2017 the federal budget contained changes meant to eliminate the exclusion currently found in Section 34(a) of the ITA.

Essentially, the change is meant to bring professional firms into the world of full accrual accounting.

IMPACT ON LAW FIRMS

For any firms previously excluding WIP interest calculation of income, the 2018 firm taxable income will see an upward bump based on the WIP declared at year ending December 31, 2017.

2018 will be the first transition tax year to recognize these changes. Accountants will be looking to law firms to declare a WIP value for income tax purposes. Many firms will have been recording WIP on their annual financial statements, while excluding it for income tax purposes. Typically, end of year adjustments are used to adjust between financial statement income and income for income tax purposes. In other words, the method of valuating WIP used previously by law firms was for financial statement purposes only, and could be either the sum of all recorded WIP in the firm's software, or alternatively a reasonable estimate based on revenue level.

Methods a firm may use in order to accurately track its WIP: