general accounting [sections 1000 — 1800]

GENERAL ACCOUNTING SECTION 1000 financial statement concepts

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PURPOSE AND SCOPE

.01 This Section describes the concepts underlying the development and use of accounting principles in general purpose financial statements (hereafter referred to as financial statements). Such financial statements are designed to meet the common information needs of external users of financial information about an entity. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100, establishes what constitutes generally accepted accounting principles, and their sources, for private enterprises reporting in accordance with Part II of the Handbook.

.02 The Board expects this Section to be used by preparers of financial statements and accounting practitioners in exercising their professional judgment as to the application of generally accepted accounting principles and in establishing accounting policies in areas in which accounting principles are developing.

.03 This Section does not establish standards for particular measurement or disclosure issues. Nothing in the Section overrides any specific standards elsewhere in Part II of the Handbook or any other accounting principle considered to be generally accepted.

Financial statements

.04 Financial statements of profit-oriented enterprises normally include a balance sheet, income statement, statement of retained earnings and cash flow statement. Notes to financial statements and supporting schedules to which the financial statements are cross-referenced are an integral part of such statements.

.05 The content of financial statements is usually limited to financial information about transactions and events. Financial statements are based on representations of past, rather than future, transactions and events, although they often require estimates to be made in anticipation of future transactions and events and include measurements that may, by their nature, be approximations.

.06 Financial statements form part of the process of financial reporting that includes, for example, information in other reports such as a funding proposal. While many financial statement concepts also apply to such information, this Section deals specifically only with financial statements.

OBJECTIVE OF FINANCIAL STATEMENTS

.07 In the Canadian economic environment, the production of goods and the provision of services are, to a significant extent, carried out by investor-owned business enterprises in the private sector and, to a lesser extent, by government-owned business enterprises. Debt and equity markets and financial institutions act as exchange mechanisms for investment resources used by these enterprises.

.08 Ownership of profit-oriented enterprises is often segregated from management, creating a need for external communication of economic information about the entity to investors. For the purposes of this Section, investors include present and potential debt and equity investors and their advisors. Creditors and others who do not have internal access to entity information also need external reports to obtain the information they require.

.09 It is not practicable to expect financial statements to satisfy the many and varied information needs of all external users of information about an entity. Consequently, the objective of financial statements for profit-oriented enterprises focuses primarily on information needs of investors and creditors. Financial statements prepared to satisfy these needs are often used by others who need external reporting of information about an entity.

.10 In making resource allocation decisions investors and creditors of profit-oriented enterprises are interested in predicting the ability of the entity to earn income and generate cash flows in the future to meet its obligations and to generate a return on investment.

.11 Investors also require information about how the management of an entity has discharged its stewardship responsibility to those that have provided resources to the entity.

Objective

.12 The objective of financial statements is to communicate information that is useful to investors, creditors and other users ("users") in making their resource allocation decisions and/or assessing management stewardship. Consequently, financial statements provide information about:

(a) an entity's economic resources, obligations and equity;

(b) changes in an entity's economic resources, obligations and equity; and

(c) the economic performance of the entity.

BENEFIT VERSUS COST CONSTRAINT

.13 The benefits expected to arise from providing information in financial statements should exceed the cost of doing so. In developing accounting standards, the Board weighs the anticipated costs and benefits of its proposals in general terms to assess whether they are justified on cost / benefit grounds. The benefits and costs of applying accounting standards may differ between entities depending in part on the nature, number and information needs of the users of their financial statements. Therefore, in developing an accounting standard, the Board considers whether the requirements of that standard should apply to all entities or whether different requirements should apply to different types of entities for which the cost / benefit trade-off differs significantly. The cost / benefit trade-off is also a consideration for individual entities in the preparation of financial statements in accordance with applicable standards (for example, in considering disclosure of information beyond that required by the standards). The Board recognizes that the evaluation of the nature and amount of benefits and costs is substantially a judgmental process.

MATERIALITY

.14 Users are interested in information that may affect their decision making. Materiality is the term used to describe the significance of financial statement information to decision makers. An item of information, or an aggregate of items, is material if it is probable that its omission or misstatement would influence or change a decision. Materiality is a matter of professional judgment in the particular circumstances.

QUALITATIVE CHARACTERISTICS

.15 Qualitative characteristics define and describe the attributes of information provided in financial statements that make that information useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

.16 For the information provided in financial statements to be useful, it must be capable of being understood by users. Users are assumed to have a reasonable understanding of business and economic activities and accounting, together with a willingness to study the information with reasonable diligence.

Relevance

.17 For the information provided in financial statements to be useful, it must be relevant to the decisions made by users. Information is relevant by its nature when it can influence the decisions of users by helping them evaluate the financial impact of past, present or future transactions and events or confirm, or correct, previous evaluations. Relevance is achieved through information that has predictive value or feedback value and by its timeliness.

(a) Predictive value and feedback value

Information that helps users to predict an entity's future income and cash flows has predictive value. Although information provided in financial statements will not normally be a prediction in itself, it may be useful in making predictions. For example, the predictive value of the income statement is enhanced if abnormal items are separately disclosed. Information that confirms or corrects previous predictions has feedback value. Information often has both predictive value and feedback value.

(b) Timeliness

For information to be useful for decision making, it must be received by the decision maker before it loses its capacity to influence decisions. The usefulness of information for decision making declines as time elapses.

Reliability

.18 For the information provided in financial statements to be useful, it must be reliable. Information is reliable when it is in agreement with the actual underlying transactions and events, the agreement is capable of independent verification and the information is reasonably free from error and bias. Reliability is achieved through representational faithfulness, verifiability and neutrality. Neutrality is affected by the use of conservatism in making judgments under conditions of uncertainty.

(a) Representational faithfulness

Representational faithfulness is achieved when transactions and events affecting the entity are presented in financial statements in a manner that is in agreement with the actual underlying transactions and events. Thus, transactions and events are accounted for and presented in a manner that conveys their substance rather than necessarily their legal or other form.

The substance of transactions and events may not always be consistent with that apparent from their legal or other form. To determine the substance of a transaction or event, it may be necessary to consider a group of related transactions and events as a whole. The determination of the substance of a transaction or event will be a matter of professional judgment in the circumstances.

(b) Verifiability

The financial statement representation of a transaction or event is verifiable if knowledgeable and independent observers would concur that it is in agreement with the actual underlying transaction or event with a reasonable degree of precision. Verifiability focuses on the correct application of a basis of measurement rather than its appropriateness.

(c) Neutrality

Information is neutral when it is free from bias that would lead users toward making decisions that are influenced by the way the information is measured or presented. Bias in measurement occurs when a measure tends to consistently overstate or understate the items being measured. In the selection of accounting principles, bias may occur when the selection is made with the interests of particular users or with particular economic or political objectives in mind.

Financial statements that do not include everything necessary for faithful representation of transactions and events affecting the entity would be incomplete and, therefore, potentially biased.

(d) Conservatism

Use of conservatism in making judgments under conditions of uncertainty affects the neutrality of financial statements in an acceptable manner. When uncertainty exists, estimates of a conservative nature attempt to ensure that assets, revenues and gains are not overstated and, conversely, that liabilities, expenses and losses are not understated. However, conservatism does not encompass the deliberate understatement of assets, revenues and gains or the deliberate overstatement of liabilities, expenses and losses.

Comparability

.19 Comparability is a characteristic of the relationship between two pieces of information rather than of a particular piece of information by itself. It enables users to identify similarities in and differences between the information provided by two sets of financial statements. Comparability is important when comparing the financial statements of two different entities and when comparing the financial statements of the same entity over two periods or at two different points in time.

.20 Comparability in the financial statements of an entity is enhanced when the same accounting policies are used consistently from period to period. Consistency helps prevent misconceptions that might result from the application of different accounting policies in different periods. When a change in accounting policy is deemed to be appropriate, disclosure of the effects of the change may be necessary to maintain comparability.

Qualitative characteristics trade-off

.21 In practice, a trade-off between qualitative characteristics is often necessary, particularly between relevance and reliability. For example, there is often a trade-off between the timeliness of producing financial statements and the reliability of the information reported in the statements. Generally, the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

ELEMENTS OF FINANCIAL STATEMENTS

.22 Elements of financial statements are the basic categories of items portrayed therein in order to meet the objective of financial statements. There are two types of elements: those that describe the economic resources, obligations and equity of an entity at a point in time, and those that describe changes in economic resources, obligations and equity over a period of time. Notes to financial statements, which are useful for the purpose of clarification or further explanation of the items in financial statements, while an integral part of financial statements, are not considered to be an element.

.23 In the case of profit-oriented enterprises, net income is the residual amount after expenses and losses are deducted from revenues and gains. Net income generally includes all transactions and events increasing or decreasing the equity of the profit-oriented enterprise except those that result from equity contributions and distributions.

Assets

.24 Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained.

.25 Assets have three essential characteristics:

(a) they embody a future benefit that involves a capacity, singly or in combination with other assets, in the case of profit-oriented enterprises, to contribute directly or indirectly to future net cash flows;

(b) the entity can control access to the benefit; and

(c) the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred.

.26 It is not essential for control of access to the benefit to be legally enforceable for a resource to be an asset, provided the entity can control its use by other means.

.27 There is a close association between incurring expenditures and generating assets but the two do not necessarily coincide. Hence, when an entity incurs an expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly, the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet. For example, items that have been donated to the entity may satisfy the definition of an asset.

Liabilities

.28 Liabilities are obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future.

.29 Liabilities have three essential characteristics:

(a) they embody a duty or responsibility to others that entails settlement by future transfer or use of assets, provision of services or other yielding of economic benefits, at a specified or determinable date, on occurrence of a specified event, or on demand;

(b) the duty or responsibility obligates the entity leaving it little or no discretion to avoid it; and

(c) the transaction or event obligating the entity has already occurred.

.30 Liabilities do not have to be legally enforceable provided that they otherwise meet the definition of liabilities; they can be based on equitable or constructive obligations. An equitable obligation is a duty based on ethical or moral considerations. A constructive obligation is one that can be inferred from the facts in a particular situation as opposed to a contractually based obligation.

Equity

.31 Equity is the ownership interest in the assets of a profit-oriented enterprise after deducting its liabilities. While equity of a profit-oriented enterprise in total is a residual, it includes specific categories of items (for example, types of share capital, contributed surplus and retained earnings).

Revenues

.32 Revenues are increases in economic resources, either by way of inflows or enhancements of assets or reductions of liabilities, resulting from the ordinary activities of an entity. Revenues of entities normally arise from the sale of goods, the rendering of services or the use by others of entity resources yielding rent, interest, royalties or dividends.

Expenses

.33 Expenses are decreases in economic resources, either by way of outflows or reductions of assets or incurrences of liabilities, resulting from an entity's ordinary revenue generating or service delivery activities.

Gains

.34 Gains are increases in equity from peripheral or incidental transactions and events affecting an entity and from all other transactions, events and circumstances affecting the entity except those that result from revenues or equity contributions.

Losses

.35 Losses are decreases in equity from peripheral or incidental transactions and events affecting an entity and from all other transactions, events and circumstances affecting the entity except those that result from expenses or distributions of equity.

RECOGNITION CRITERIA

.36 Recognition is the process of including an item in the financial statements of an entity. Recognition consists of the addition of the amount involved into statement totals together with a narrative description of the item (for example, "inventory" or "sales") in a statement. Similar items may be grouped together in the financial statements for the purpose of presentation.

.37 Recognition means inclusion of an item within one or more individual statements and does not mean disclosure in the notes to the financial statements. Notes either provide further details about items recognized in the financial statements, or provide information about items that do not meet the criteria for recognition and thus are not recognized in the financial statements.

.38 The recognition criteria below provide general guidance on when an item is recognized in the financial statements. Whether any particular item is recognized or not will require the application of professional judgment in considering whether the specific circumstances meet the recognition criteria.

.39 The recognition criteria are as follows:

(a) the item has an appropriate basis of measurement and a reasonable estimate can be made of the amount involved; and

(b) for items involving obtaining or giving up future economic benefits, it is probable that such benefits will be obtained or given up.

.40 It is possible that an item will meet the definition of an element but still not be recognized in the financial statements because it is not probable that future economic benefits will be obtained or given up or because a reasonable estimate cannot be made of the amount involved. It may be appropriate to provide information about items that do not meet the recognition criteria in notes to the financial statements. Not recognizing an expenditure as an asset does not imply either that the intention of management in incurring the expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

.41 Items recognized in financial statements are accounted for in accordance with the accrual basis of accounting. The accrual basis of accounting recognizes the effect of transactions and events in the period in which the transactions and events occur, regardless of whether there has been a receipt or payment of cash or its equivalent.

.42 Revenues are generally recognized when performance is achieved and reasonable assurance regarding measurement and collectibility of the consideration exists.

.43 Gains are generally recognized when realized.

.44 Expenses and losses are generally recognized when an expenditure or previously recognized asset does not have future economic benefit. Expenses are related to a period on the basis of transactions or events occurring in that period or by allocation.

.45 Expenses are recognized in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events. For example, the various components of expense making up the cost of goods sold are recognized at the same time as the income derived from the sale of the goods. However, the application of the matching concept does not allow the recognition of items in the balance sheet that do not meet the definition of assets or liabilities.

.46 When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognized in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognizing the expenses associated with the using up of assets such as property, plant, equipment, patents and trademarks. In such cases, the expense is referred to as depreciation or amortization. These allocation procedures are intended to recognize expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.

.47 An expense is recognized immediately in the income statement when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.

MEASUREMENT

.48 Measurement is the process of determining the amount at which an item is recognized in the financial statements. There are a number of bases on which an amount can be measured. However, financial statements are prepared primarily using the historical cost basis of measurement whereby transactions and events are recognized in financial statements at the amount of cash or cash equivalents paid or received or the fair value ascribed to them when they took place.

.49 Other bases of measurement are also used but only in limited circumstances. They include:

(a) Replacement cost — the amount that would be needed currently to acquire an equivalent asset. This may be used, for example, when inventories are valued at the lower of historical cost and replacement cost.

(b) Realizable value — the amount that would be received by selling an asset. This may be used, for example, to value temporary and portfolio investments. Market value may be used to estimate realizable value when a market for an asset exists.

(c) Present value — the discounted amount of future cash flows expected to be received from an asset or required to settle a liability. This may be used, for example, to estimate the cost of pension benefits.

.50 Financial statements are prepared with capital maintenance measured in financial terms and with no adjustment being made for the effect on capital of a change in the general purchasing power of the currency during the period.

.51 The concept of capital maintenance used by profit-oriented enterprises in preparing financial statements affects measurement because income in an economic sense exists only after the capital of an enterprise has been maintained. Thus, income is the increase or decrease in the amount of capital at the end of the period over the amount at the beginning of the period, excluding the effects of capital contributions and distributions.

.52 Financial statements are prepared on the assumption that the entity is a going concern, meaning it will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of operations. Different bases of measurement may be appropriate when the entity is not expected to continue in operation for the foreseeable future.

EFFECTIVE DATE

.53 This Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.
