

# Generally Accepted Accounting Principles — Background Information and Basis for Conclusions

## Section 1100

### Foreword

The pre-changeover standards in Part V of the CPA Canada Handbook – Accounting, which included this Basis for Conclusions document, have been removed from the Handbook. This Basis for Conclusions was developed to accompany the pre-changeover standard and, since that standard was fully converged with Part II of the Handbook, it remains relevant.

Background Information and Basis for Conclusions documents are primary sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100. These documents are intended to help readers understand how the Accounting Standards Board reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Handbook Section or Accounting Guideline.

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## **INTRODUCTION**

- 1 This document summarizes considerations that were deemed significant by the members of the Accounting Standards Board (AcSB) in reaching the conclusions in **GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**, Section 1100, and related amendments to other CICA Handbook – Accounting material. This document sets out the reasons the AcSB undertook the project to develop this material, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors.
- 2 Nothing in this document is to be taken as overriding the requirements of Accounting Handbook Sections. However, the discussion may assist readers in understanding how the AcSB reached its conclusions in developing Section 1100 and the AcSB's intent with respect to its interpretation and application.

## **BACKGROUND**

- 3 It is useful to bear in mind the relationship between accounting standards and generally accepted accounting principles (GAAP). GAAP encompasses broad principles and conventions of general application as well as rules and procedures that determine accepted accounting practices at a particular time. Pronouncements issued by the AcSB and by the Emerging Issues Committee (EIC), which are primary sources of GAAP, represent only part of GAAP.
- 4 The CICA Handbook – Accounting is silent or provides limited guidance in certain specific areas. This does not imply, however, that entities may do whatever they please. Section 1100 provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures, when a matter is not dealt with explicitly in the primary sources of GAAP.
- 5 Before the issue of **GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**, Section 1100, GAAP was described as the basis on which financial statements are normally prepared, comprising the Accounting Recommendations in the CICA Handbook – Accounting and, when a matter is not covered by a Recommendation, other accounting principles that either:
  - (a) are generally accepted by virtue of their use in similar circumstances by a significant number of entities in Canada; or
  - (b) are consistent with the Recommendations in the Handbook and are developed through the exercise of professional judgment, including consultation with other informed accountants where appropriate, and the application of the concepts described in **FINANCIAL STATEMENT CONCEPTS**, Section 1000.

Section 1000 also identified sources to which reference would be made in exercising professional judgment.

## **RATIONALE FOR GAAP PROJECT**

- 6 The AcSB added the GAAP project to its agenda to address the following issues and concerns:
  - (a) The hierarchy of Accounting Handbook Sections, Accounting Guidelines and Emerging Issues Committee Abstracts of Issues Discussed (EIC Abstracts) required clarification. In particular, the EIC informed the AcSB that:
    - (i) questions arose from time to time, in practice, as to the status and authoritativeness of Guidelines and Abstracts;
    - (ii) provincial institute / ordre practice advisors and inspectors reported that some practitioners ignore Guidelines and Abstracts or questioned the need to apply them to private entities; and
    - (iii) the status of Abstracts issued by the Emerging Issues Task Force within the hierarchy of US GAAP had recently been clarified. 1

- (b) New forms of guidance such as Background Information and Basis for Conclusions documents, as well as Implementation Guides, had been developed and readers were not sure of the status of this material.
  - (c) Securities Commission staff members were concerned that GAAP was being developed based on the consensus of informal groups of entities and their advisors who might confer and agree on an approach to an issue. Some interpreted the previous guidance to permit GAAP to include so-called "industry practice" that did not consider other sources of GAAP.
  - (d) Securities Commission staff members were concerned that isolated precedents were cited as justification for practices that contravene the spirit, if not the letter, of CICA Handbook – Accounting concepts and standards.
  - (e) Not enough attention was given to non-italicized paragraphs.
  - (f) The status of the material accompanying an Accounting Recommendation, such as Appendices, was unclear.
  - (g) The status of international GAAP, which had undergone significant change was unclear.
  - (h) The need to clarify what is meant by fair presentation in accordance with generally accepted accounting principles.
- 7 Input to the deliberations of the AcSB comprised comments received to proposals issued in July 2001, 2 modified proposals issued in September 2002 3 and results of a roundtable discussion conducted in February 2003.
- 8 Respondents generally supported the need to define a GAAP hierarchy in Canada. As well, respondents generally welcomed the improved clarity and simplicity in the modified proposals. The AcSB re-deliberated the issues and decided to make further modifications as indicated in this document.
- 9 GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION, Section 1400, is closely linked to Section 1100 and the AcSB advises readers to review the separate Background Information and Basis for Conclusions document.

#### **PURPOSE AND SCOPE**

- 10 The AcSB believes that the final text of the Purpose and Scope more fully recognizes its intent since the Section describes what constitutes GAAP, and also provides guidance on sources to consult when a matter is not dealt with explicitly in the primary sources of GAAP.
- 11 Very few respondents to the proposals commented on the Purpose and Scope. Some respondents suggested that the word "Canadian" precede the term "GAAP" throughout the Section. The AcSB concluded that it would be repetitive to insert the word "Canadian" every time GAAP was mentioned and that it would be sufficient to refer to "Canadian generally accepted accounting principles" in the first paragraph. Further references to GAAP are understood to refer to Canadian GAAP.

#### **DEFINITIONS**

- 12 Definitions of "accounting policies", "generally accepted accounting principles" and "primary sources of GAAP" are provided to help a reader understand key terms.
- 13 The definition of "accounting policies" is consistent with its use in DISCLOSURE OF ACCOUNTING POLICIES, Section 1505, and ACCOUNTING CHANGES, Section 1506.
- 14 The definition of "generally accepted accounting principles" is largely consistent with how the term was used previously in FINANCIAL STATEMENT CONCEPTS, Section 1000. In its re-deliberations, the AcSB agreed to emphasize principles rather than rules, as suggested by a participant in the February 2003 roundtable discussion.
- 15 The definitions set out in Section 1100 identify the primary sources of GAAP in descending order of authority. The AcSB believes that differences in authority within the primary sources of GAAP are required to resolve any conflicts that may arise within these sources. A source higher up the hierarchy will always "trump" a lower source. The AcSB re-deliberated the order and decided to rank EIC Abstracts ahead of Background Information and Basis for Conclusions (Basis) documents, since Basis documents provide helpful rationale while EIC Abstracts are stand-alone sources of GAAP that are developed taking into account all other higher sources including the rationale in Basis documents.
- 16 Paragraph 1100.02(c) clarifies that it is Basis documents "accompanying pronouncements described in (i)-(ii)" that are primary sources of GAAP, rather than preliminary Basis documents that accompany exposure drafts.
- 17 The AcSB included a footnote to paragraph 1100.02(c)(v) to clarify that the status of decision trees and examples embedded in Accounting Handbook Sections have the same authority as other Illustrative material.
- 18 Section 1100 is not, itself, a primary source of GAAP. However, compliance with the Section is required in order to achieve a fair presentation in accordance with GAAP, as required by GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION, paragraph 1400.04.

#### **RELATIONSHIP TO CICA PUBLIC SECTOR ACCOUNTING HANDBOOK**

- 19 The AcSB concluded that any explanation of the relationship between the CICA Public Sector Accounting Handbook and the CICA Handbook – Accounting more appropriately belonged in the Introduction to Accounting Recommendations and, accordingly, has modified the wording in paragraphs 2.-3. of the Introduction to Accounting Recommendations to conform with Section 1100 (see Consequential Amendments).

#### **SOURCES OF GAAP**

- 20 Paragraphs 1100.03-.04 set out the key requirements of the Section — to apply all relevant primary sources of GAAP and, when no relevant primary source of GAAP is available, adopt accounting policies and disclosures that are consistent with the primary sources of GAAP, are developed through the exercise of professional judgment and are reasoned within the concepts described in FINANCIAL STATEMENT CONCEPTS, Section 1000.
- 21 The AcSB adopted a principles-based approach in its re-deliberations of Section 1100 that emphasized the role of professional judgment in the selection of accounting policies and disclosures. This approach represents a shift in emphasis from the earlier proposals that emphasized the seeking of other sources to resolve accounting issues.
- 22 Professional judgment was referred to in the earlier proposals. However, some requested greater clarification of how they should apply this concept. Therefore, the AcSB expanded the discussion of professional judgment in Section 1100. Furthermore, the 1988 CICA Research Study, "Professional Judgment in Financial Reporting," provides additional information on this concept.
- 23 The starting point for selecting an appropriate accounting policy and disclosure in a particular circumstance is to consult the primary sources of GAAP. Therefore, the AcSB has emphasized the need for management to be knowledgeable, not only about the primary sources of GAAP, but also about changes to these sources. Without such knowledge, management, who is responsible for the financial statements, cannot be sure that the entity has applied every primary source of GAAP that deals with the accounting and reporting in financial statements of transactions and events encountered by the entity.
- 24 The primary sources of GAAP provide a consistent base on which all financial statements are prepared and, accordingly, the AcSB has given greater emphasis to the fact that an entity consults sources other than primary sources of GAAP to assist in selecting accounting policies and disclosures only when those other sources comply with the requirements of paragraph 1100.04.
- 25 Another key paragraph is paragraph 1100.07 that sets out four criteria that an entity uses to evaluate the sources when selecting the appropriate accounting policies and disclosures. The AcSB confirmed its conclusion that an earlier proposal whereby an entity would seek to identify the "most relevant" source of GAAP was not intended to require an entity having to look to all sources to determine which was the most relevant.
- 26 Respondents expressed concern with the proposal that once a source has been identified that complies with paragraph 1100.04, there is no need for the entity to look further. Respondents felt that this proposal might imply that an entity could ignore alternative "other sources" of GAAP, and adopt a "fringe practice" based on the one source it had identified. In revising the proposals, the AcSB adopted a more-rigorous approach to selecting other sources of GAAP. The Section now makes it clear that it is necessary for an entity to refer to other sources when the primary sources of GAAP do not deal with the accounting and reporting in financial statements of transactions or events encountered by the entity or when additional guidance is needed to apply a primary source to specific circumstances, and to evaluate those sources in accordance with the criteria in paragraph 1100.07. The AcSB also expanded the evaluation criteria to deal explicitly with the process by which guidance is developed.
- 27 Respondents' concerns about "fringe practices" were also addressed by the guidance in paragraph 1100.31 that significantly reduces the importance of industry practice. Extreme interpretations of a source do not constitute evidence that the criteria in paragraph 1100.04 have been met if it is likely that most parties, exercising professional judgment, would reject them as not resulting in a fair presentation in accordance with GAAP of the financial position, results of operations or cash flows of the entity.
- 28 A respondent expressed concern that analogizing is precluded only when a primary source of GAAP explicitly states that it applies only to the particular circumstances described therein. Although, in many cases, an entity may reason by analogy from primary sources of GAAP to develop an accounting policy, the AcSB emphasized in paragraph 1100.09 that in those cases when a primary source of GAAP specifies that it is intended to apply only to the situation dealt with therein, reasoning by analogy is precluded.
- 29 Some respondents suggested that the manner in which FINANCIAL STATEMENT CONCEPTS, Section 1000, should be consulted was not clear. The AcSB included additional material to address this concern. Paragraph 1100.10 now explains that an entity considers all the sources of GAAP that it consults in the context of Section 1000. This is intended to help an entity resolve an accounting issue when alternative treatments may appear to be possible, but one treatment is more compatible with Section 1000 than the other. The last sentence of paragraph 1100.10 was also introduced to help an entity understand how to assess compatibility with Section 1000. At the suggestion of a respondent, the AcSB included a reference to the qualitative characteristics of financial information, the elements of financial statements, and the recognition and measurement criteria of the conceptual framework.
- 30 In rare instances, there might be conflicts between the requirements of a particular Accounting Handbook Section and Section 1000 — particularly when a Section pre-dates Section 1000. The AcSB added paragraph 1100.11 to explain what to do in such circumstances. The guidance is equivalent to that in International Accounting Standards Board (IASB) "Framework for the Preparation and Presentation of Financial Statements."

#### **Role of regulatory pronouncements**

- 31 The Introduction to Accounting Recommendations previously stated that no Recommendation is intended to override the requirements of a governing statute. This statement was intended to recognize that bodies establishing governing

statutes are not bound to establish requirements that fall within GAAP. However, some have misinterpreted this statement to mean that any accounting requirement prescribed by a governing statute or regulation is automatically within GAAP.

- 32 The AcSB confirmed its view that when regulatory, legislative or contractual financial reporting requirements are within the range of acceptable choices allowed by Section 1100, the basis of accounting can be described as being in accordance with GAAP. However, if the basis of accounting used to prepare such financial statements conflicts with the requirements of the Section, that basis cannot be described as being in accordance with GAAP. The AcSB believes that users of financial statements need a consistent benchmark against which to assess financial statements and need to know when those statements have been prepared on a basis that differs from those of other entities.

- 33 The majority of respondents who commented on the role of regulatory pronouncements agreed with the proposals (except for some of those discussing rate-regulated operations — see paragraphs 87-91).

**Authority to establish GAAP**

- 34 A few respondents suggested that when an accounting policy adopted in accordance with a statute or regulation contravenes GAAP, the financial statements could be described as being in accordance with GAAP with the exception of that policy. They believe that the rest of the financial statements would be in accordance with GAAP and suggested that the notes to the financial statements indicate the effect of the difference between following the statute or regulation and GAAP. However, the AcSB does not believe that disclosure is an adequate substitute for accounting in accordance with GAAP. Furthermore, this would undermine the comparability of the primary financial statement numbers between entities that complied with GAAP and those that did not.

**Role of the AcSB**

- 35 Several respondents commented that it is important to acknowledge that the AcSB should have sole responsibility for the accounting standard-setting process in Canada. Others see the need for the AcSB to work closely with regulators to ensure that, wherever possible, the rapidly evolving needs of a specific sector are identified, prioritized and addressed in a timely manner within Canadian GAAP.

- 36 The AcSB added a sentence to paragraph 1100.12, signalling its desire to avoid conflicts and to work with regulators. As part of its ongoing communication efforts, AcSB members and staff continue to maintain extensive liaison efforts with various constituent groups such as regulators and financial analysts to serve the public interest.

**Basis of accounting**

- 37 Some respondents expressed concern that the proposals did not mention how financial statements presented in accordance with non-GAAP regulatory or legislative requirements should be referenced. Other respondents believed that the CICA Handbook – Accounting should state that if there is a statute or regulation requiring a particular accounting treatment, an entity must follow it, but the treatment would not be GAAP. Some respondents suggested that an entity would prepare GAAP statements for external use and non-GAAP statements, which follow regulatory or statutory requirements, for internal use. Other respondents expressed concern that non-GAAP statements would lead to difficulties in simultaneously meeting its regulatory requirements, as well as obligations to its shareholders and policyholders.

- 38 The AcSB seeks to minimize instances when GAAP and regulatory or legislative requirements conflict. However, any departure from GAAP that results from an entity departing from GAAP to meet any regulatory, legislative or contractual requirements would be outside of GAAP and thus, outside the mandate of the AcSB. Hence, the AcSB decided not to provide guidance on how financial statements that do not meet GAAP should be considered. The AcSB focuses on general purpose financial statements. Financial statements prepared on a different basis (for example, to meet regulatory requirements), must not be held out as being prepared in accordance with generally accepted accounting principles.

**Terminology**

- 39 The phrase "regulatory, legislative or contractual requirements" was used in place of "governing statute or regulation" and is intended to include requirements issued by federal or provincial governments and their agencies as well as securities regulators.

**Primary sources of GAAP**

- 40 The primary sources of GAAP comprise those pronouncements issued by, or authorized by, the AcSB. These sources must be applied by all entities. Paragraphs 1100.13-.22 provide additional background about the use of those pronouncements.

**Recommendations and non-italicized paragraphs**

- 41 Section 1100 emphasizes that Recommendations and non-italicized paragraphs in Accounting Handbook Sections have equal authority. This addresses one of the specific concerns that led to the commencement of the GAAP project. This view is consistent with that emphasized by the IASB in its revised Preface to International Financial Reporting Standards (May 2002), paragraph 14, with respect to its Standards. It is also consistent with the principles-based approach to Canadian accounting standards, whereby the principles are clearly identified, but the additional guidance necessary to apply those principles is equally important. The approach is also more consistent with US Financial Accounting Standards Board (FASB) Standards, which do not distinguish different parts of the text from one another in

- terms of their relative authority. The AcSB decided, however, not to eliminate the use of italics since, among other things, italics are a useful means to identify the main principles in Accounting Handbook Sections.
- 42 Sometimes there might appear to be more than one way of interpreting non-italicized paragraphs. The AcSB included the last sentence in paragraph 1100.13 to explain that, in such circumstances, an entity would select the interpretation that is most consistent with the italicized Recommendations in the standard. It is not appropriate to interpret non-italicized material in a way that is inconsistent with the principles on which a standard is based.
- Encouraged or desirable disclosures**
- 43 Some respondents suggested that the proposals could be interpreted to require encouraged or desirable disclosures given that italicized and non-italicized paragraphs have equal authority. The AcSB clarified that it did not intend to change the status of encouraged or desirable disclosures by inserting "but not required" when describing these disclosures in paragraph 1100.13.
- 44 The AcSB plans to reconsider encouraged or desirable disclosures in future projects.
- Board notices**
- 45 The AcSB publishes Accounting Handbook Sections and Accounting Guidelines under its own authority. The AcSB also publishes Background Information and Basis for Conclusions documents as well as authorizes Implementation Guides and Illustrative material to support those Accounting Handbook Sections and Accounting Guidelines. The Emerging Issues Committee publishes EIC Abstracts. However, the process whereby these documents are issued does not allow for prompt clarification of Accounting Handbook Sections or Accounting Guidelines. Sometimes, the required clarification is obvious and additional consultation would result in unnecessary delay.
- 46 The AcSB will use Board Notices to clarify certain aspects of an Accounting Handbook Section or Accounting Guideline when it becomes apparent that the text does not adequately convey the AcSB's intent. Board Notices would be withdrawn as soon as the underlying Accounting Handbook Section or Accounting Guideline that gave rise to them could be amended or the circumstances are no longer relevant. Board Notices will require the same level of approval as the primary source of GAAP that they will clarify.
- 47 Board Notices are a primary source of GAAP on the same level as the primary source that they clarify; otherwise, constituents could choose to ignore a Board Notice if it had lesser authority in the hierarchy than the primary source material being clarified.
- 48 Some believe that the introduction of Board Notices might be confusing for constituents and unnecessary in light of other primary sources of GAAP such as Accounting Guidelines or EIC Abstracts. However, others note that:
- (a) the AcSB needs an effective means to convey a decision quickly;
  - (b) any such vehicle must have a clear position within Section 1100 to give it authority;
  - (c) the purpose of a Board Notice would be limited — merely a notice of a clarification the AcSB has decided to make to either Accounting Handbook Sections or Accounting Guidelines since neither pronouncement adequately conveys the AcSB's intent; and
  - (d) Board Notices would solve an administrative problem because the current process only allows for changes to the CICA Handbook – Accounting once a month.
- 49 Board Notices are presently available on the AcSB web site at [www.acsbcanada.org](http://www.acsbcanada.org) and an archival process will be developed to retain a history of Board Notices for reference purposes.
- EIC Abstracts**
- 50 Some respondents requested clarification of what was meant by "other material designated by the Abstract." Paragraph 1100.20 now clarifies the AcSB's intent — some EIC Abstracts include material that illustrates the application of a consensus to assist in clarifying its meaning. These illustrations of the application of a consensus have the same level of authority as Illustrative material.
- Basis documents**
- 51 Some respondents questioned the authority of Basis documents that accompany exposure drafts of Accounting Handbook Sections or Accounting Guidelines. Paragraph 1100.02(c)(iv) now refers more explicitly to the documents that Basis documents support, i.e., Accounting Handbook Sections and Accounting Guidelines.
- 52 Some respondents suggested that Basis documents be part of the CICA Handbook – Accounting. The AcSB notes that Basis documents that accompany final Handbook material are included in the electronic database that includes the official version of the CICA Handbook – Accounting.
- Appendices and illustrative examples**
- 53 Currently, Appendices, Illustrative Examples and material accompanying certain pronouncements do not use consistent terminology to denote differences in their intended level of authority. The AcSB is reviewing and making necessary consequential amendments to the introduction to each Appendix, Illustrative Example and other material to clarify its status in accordance with paragraphs 1100.18-.19, in conjunction with its Accounting Standards Improvements project. Until such time as relevant amendments have been made, a table posted on the AcSB web site at [www.acsbcanada.org](http://www.acsbcanada.org) (see Completed Projects page for "Generally Accepted Accounting Principles") sets out the authoritative nature of this

material appearing in Accounting Handbook Sections and Accounting Guidelines. The EIC will make consequential amendments to its Abstracts in due course.

- 54 Some respondents questioned the status of examples embedded within the body of certain Sections such as in EMPLOYEE FUTURE BENEFITS, Section 3461. The AcSB concluded that the authoritative status of such material does not change merely because it is included within the body of certain Sections for clarity or ease of reference. The AcSB added a footnote to paragraph 1100.02(c)(v) to indicate that embedded examples as well as a decision tree embedded within Section 3461 have the same status as other Illustrative material.

**Implementation guides**

- 55 Implementation Guides constitute primary sources of GAAP only when the AcSB has specifically authorized their development. In such cases, they explicitly state "the AcSB has authorized the development." Similar documents that do not contain such a statement, perhaps developed by others, do not constitute primary sources of GAAP, although they might be useful sources to consult in selecting accounting policies and disclosures that comply with paragraph 1100.04. The fact that a guide developed by others is accompanied by a foreword or other commentary provided by a representative of the AcSB or its staff does not mean that the guide is authorized by the AcSB or that the guide is a primary source of GAAP.

**Information outside financial statements**

- 56 Primary sources of GAAP may address matters relating to financial information that is not part of the financial statements. For example, ACCOUNTING GUIDELINE AcG-7, The Management Report, provides views on the minimum content of a management report that accompanies, but is not part of, the annual financial statements. Paragraph 1100.22 explains that Section 1100 requires only those primary sources of GAAP that deal with accounting and reporting in financial statements to be applied. Section 1100 does not address matters relating to financial information that is not part of the financial statements. As a result, for financial statements to "present fairly in accordance with GAAP", it is not necessary to apply those sources that deal with accounting and reporting outside the financial statements. However, application of those sources is desirable.

**Other sources**

- 57 The AcSB has identified a number of other sources to assist an entity in selecting accounting policies and disclosures that comply with paragraph 1100.04. These other sources do not have an order of authority like the primary sources of GAAP, since the selection of the appropriate accounting policy and disclosure takes into account not only compliance with the requirements of paragraph 1100.04, but also the criteria in paragraph 1100.07 and the exercise of professional judgment. The AcSB emphasizes the use of professional judgment to determine which source an entity should use. Furthermore, Section 1100 identifies some of the other sources that an entity might consult to assist in selecting accounting policies and disclosures, but, these sources are not necessarily a comprehensive list.
- 58 Some respondents questioned the necessity of referring to other sources when no primary source of GAAP deals with the accounting and reporting in financial statements of transactions or events encountered by an entity. In particular, some suggested that an entity might be able to find a solution to an issue not covered by primary sources of GAAP by reasoning from FINANCIAL STATEMENT CONCEPTS, Section 1000, alone. The AcSB concluded that it is necessary for an entity to not only apply the concepts in Section 1000, but also to ensure that accounting policies and disclosures adopted are consistent with primary sources of GAAP. Often the entity will also consult additional other sources of GAAP.
- 59 Entities will need to re-evaluate their selection of other sources of GAAP each period since sources of GAAP continue to evolve. For example, primary sources as well as other sources may have been added, amended or withdrawn.

**The role of international standards**

- 60 The AcSB supports the global convergence of standards by participating with other standard setters in joint projects to develop new standards. The AcSB also supports harmonizing current Canadian accounting standards with US Standards where appropriate. Accordingly, the AcSB cites accounting pronouncements published with the authority of the FASB and the IASB as often being important sources to consult. In cases where these Standards are converged with or harmonized with Canadian standards, an entity that consults these sources is likely to have a high degree of assurance that the additional guidance in the corresponding US or international pronouncement generally satisfies the requirements of paragraph 1100.04.
- 61 Some respondents wondered about the relative authority of US GAAP and IASB Standards, suggesting, for example, that they believe FASB pronouncements would generally be the point of reference rather than IASB pronouncements. Some respondents suggested US and IASB sources should be considered relevant only when the Canadian circumstances are similar to those described in the foreign Standard. A view was also expressed that IASB pronouncements should be consulted in preference to US GAAP. The AcSB concluded that it is not appropriate to show a preference to US GAAP or IASB Standards, but rather to link the AcSB's objectives of global convergence and harmonization with US GAAP to the selection of sources. The selection of an appropriate accounting policy and disclosure takes into account the criteria in paragraph 1100.07 and requires the exercise of professional judgment.
- 62 Many respondents did not believe that the role of foreign standards was sufficiently clear. Several respondents wondered when to apply more-specific foreign guidance, in particular, whether accountants would be required to consult references beyond Canadian sources. Some respondents expressed concern about the practicalities of being

- knowledgeable about foreign sources. Some respondents were particularly concerned that accountants might be required to expand their knowledge base to include US GAAP. Some respondents expressed concern about what parts of US GAAP, if any, must be consulted. The AcSB addressed these concerns by providing explanations in paragraphs 1100.24-.26.
- 63 Some respondents questioned the extent to which an entity would consult US or other international literature. Section 1100 points out that it is not necessary to comply with US or other international literature in order to comply with Canadian GAAP. However, when a primary source of GAAP has been harmonized with, for example, a US or international pronouncement, more-detailed and fact-specific guidance in the corresponding US or international pronouncement generally satisfies the requirements of paragraph 1100.04 and it may, therefore, be convenient to refer to that source. Basis documents will often elaborate on any conscious decisions that the AcSB has made to harmonize, or to not pick up certain aspects of a US or international pronouncement.
- 64 Some respondents noted that some users may not understand the structure and authority of foreign GAAP, and thus may misapply a pronouncement that is dependent upon the authority of a higher-level pronouncement within that foreign body of GAAP. Other respondents expressed concern about the apparent ability to select isolated pieces of foreign GAAP without considering the framework in which they were developed. Some suggested that pronouncements published with the authority of a foreign standard setter should be applied only in accordance with the relative authority of those pronouncements within their own GAAP hierarchies.
- 65 The AcSB addressed these concerns by stating that when an entity chooses to consult the sources described in paragraphs 1100.24-.25, it would evaluate the source in the context of the relative manner in which the standard setter requires its pronouncements to be applied, as well as in the context of the related pronouncement. For example, in consulting a FASB Emerging Issues Task Force Abstract (EITF Abstract), an entity would evaluate that EITF Abstract in the context of the relative manner in which US GAAP requires these EITF Abstracts to be applied, namely, SAS 69, which includes EITF Abstracts in category (c). An entity would consult that EITF Abstract in the context of the source it interprets, such as a FASB Statement of Financial Accounting Standards. Similarly, an entity would evaluate an International Financial Reporting Standard in the context of the selection of accounting policies guidance in paragraph 22 of IAS 1 (revised 1997), "Presentation of Financial Statements." 4
- 66 Some respondents requested a list of harmonized standards. The AcSB confirmed its view that making a list of harmonized standards would prove very difficult. In future projects, the AcSB will consider including a brief explanation about the extent to which the material is harmonized with US and international standards.
- 67 Some respondents questioned the meaning of "published with the authority of the US FASB." This phrase was intended to refer to only those pronouncements published by the FASB itself; adopted by the FASB, such as AICPA Accounting Research Bulletins; or given negative clearance by the FASB, such as AICPA Industry Accounting Guides and AICPA Statements of Position. However, the significance of the phrase is less in Section 1100. The AcSB notes that other sources, such as Securities and Exchange Commission (SEC) guidance, might also be useful sources to consult in particular circumstances, although they may be less likely to be harmonized with primary sources of GAAP.
- 68 A respondent questioned whether subsequent changes in US GAAP or IASB Standards that have been relied upon by an entity in order to support an accounting policy would automatically require a change in policy for purposes of reporting under Canadian GAAP. An entity relying on a foreign source of GAAP would have satisfied itself that the source complied with the requirements in paragraph 1100.04. If the foreign source changes, the entity would consider the reasons for the change to determine whether it would alter its assessment. (Also see paragraph 59 of this document.)
- 69 Since Section 1100 is developed for use within the Canadian environment, those sources that take the Canadian environment into account are likely to be more relevant, and therefore to be consulted in preference to those that do not. Primary sources of Canadian GAAP are consulted in preference to foreign sources. The preference for sources that take the Canadian environment into account also applies to other sources such as research reports, research studies, and accounting textbooks, journals, studies and articles.
- 70 Some respondents expressed concern that an entity might adopt different accounting treatments under Canadian and US GAAP for the same transaction or event when the treatment required in the US is also acceptable under Canadian GAAP (a voluntary US-Canadian GAAP reconciling item). The AcSB concluded that it was not appropriate for the AcSB to discourage voluntary differences, but observes that reconciliations provide valuable information in such cases.
- Guides not authorized by the Board**
- 71 Guides not authorized by the Board may provide guidance on an area not covered by any other material. As with other possible sources, an entity consults such guides provided they comply with the requirements of paragraph 1100.04, and evaluates those sources based on all four criteria in paragraph 1100.07.
- 72 A respondent suggested that the AcSB provide a definition of an "industry guide", or at least a description, or examples. The AcSB does not wish to single out any particular guide nor is it practical to publish a list. However, the AcSB does note that some industry associations have produced guides that comment on the application of GAAP within their particular industry.
- Approved drafts**
- 73 As in the proposals, the AcSB included approved drafts of primary sources of GAAP as potential sources to consult when no primary source of GAAP applies to a particular situation. Few respondents commented on this aspect of the



proposals. The view was expressed that this proposal was a positive step forward. However, the view was also expressed that a draft cannot be considered "generally accepted" until it has been issued in final form. The AcSB concluded that an entity is permitted to refer to drafts only if the transition rules would permit early adoption. The AcSB modified its proposals to explicitly state that an entity would not apply a proposal in an approved draft that conflicts with FINANCIAL STATEMENT CONCEPTS, Section 1000, or a primary source of GAAP. Section 1100 also now states that an entity is not required to apply a proposal in an approved draft until the resulting primary source becomes effective.

- 74 The AcSB has also noted that care should be taken to ensure that any source has not been superseded by more-advanced thinking. This applies not only to approved drafts of primary sources of GAAP, but also to other sources of GAAP. If a draft has been superseded, the document at the more-advanced stage should be consulted.

#### **Research reports and research studies**

- 75 As in the proposals, a study group's conclusions in a research report or research study may be a possible source to consult, provided the entity complies with the requirements of paragraph 1100.04. This possibility is not limited to reports or studies issued by the CICA Research Studies department. Reports or studies issued by other organizations might also be useful sources to consult.

#### **Practice**

- 76 As indicated previously, Securities Commission staff members have expressed concern about GAAP developing, based on the consensus of informal groups of entities and their advisors, who confer and agree on an approach to an issue. Some have interpreted the prior wording of FINANCIAL STATEMENT CONCEPTS, paragraph 1000.60(a), to suggest that when a significant number of entities account for something in a certain way, that is GAAP. Securities Commission staff members have also expressed concern about the frequency with which isolated precedents are cited as justification for practices that contravene the spirit, if not the letter, of CICA Handbook – Accounting concepts and standards.
- 77 Some respondents expressed concern that downplaying industry practice will reduce the quality of financial reporting as the substance and economic realities of a business may be ignored. Some respondents cited examples of the real estate industry and rate-regulated operations.
- 78 Some of these respondents held the view that Canadian real estate companies would be precluded from using the sinking-fund method of depreciation for depreciating investment properties. Since US GAAP specifically prohibits the sinking-fund method of depreciation, these respondents argue that Canadian GAAP would not permit this method of depreciation as an entity would look to US GAAP as its "other source of GAAP". These respondents also expressed concern that applying a retroactive transitional method to change from the sinking-fund method to either straight-line or declining balance would have a material impact on their financial results. The AcSB did not debate whether the CICA Handbook – Accounting precludes the use of the sinking-fund method of depreciation. It appeared to the AcSB that respondents misconstrued the role of other sources. (See Other sources, paragraphs 57-62, for details about the changes that the AcSB made to this role. Also see paragraphs 1100.24-.26.) However, the AcSB considered the broader issue of transition to the new standard for all entities. (See Transitional provisions for details.)
- 79 Some respondents questioned the degree of rigour in applying industry practice. The AcSB has emphasized that if industry practice is consulted, it is insufficient for it to be used generally or within a particular industry. The entity must also be satisfied that the criteria in paragraph 1100.04 have been met.

### **TRANSITIONAL PROVISIONS**

#### **Effective date**

- 80 The AcSB agreed to retain the October 1, 2003 effective date as proposed in the September 2002 Re-exposure Draft.
- 81 Some respondents could foresee problems for entities that may have to change their accounting systems to adopt a primary source of GAAP that they have not previously followed. Some respondents commented that the proposals may require significant changes for entities whose financial statements would be considered in accordance with GAAP in one period, and in the next must change either the application of GAAP or discontinue reliance on sources that do not satisfy the criteria in paragraph 1100.04. The AcSB believes that the announcement of the intended effective date at the time of issuance of its proposals in September 2002 gave entities sufficient time to prepare for any necessary changes. During its re-deliberations, the AcSB noted that the key principles remained the same throughout the exposure process. Also, as discussed later under Prospective application, the AcSB decided to require application to events and transactions occurring after the date of adoption and to any outstanding related balances existing at the date of adoption, rather than retroactive application. This is intended to facilitate adoption by the October 1, 2003 effective date.
- 82 The AcSB encourages earlier adoption, and agrees with a respondent, that in order to produce the required consistency the proposals seek, the earlier the implementation the better.

#### **Prospective application**

- 83 Some respondents argued for consistency of application and comparability of financial statements between reporting periods and among individual entities. Some respondents argued that an absence of transitional provisions (and the effective date) would lead to diverse practice in implementation. Some respondents commented that without transitional

- provisions, the proposals would be impracticable to apply and requested a clear understanding of how to apply the requirements.
- 84 The AcSB re-deliberated whether it should require that all changes in accounting policy on adopting the new Section be accounted for in accordance with ACCOUNTING CHANGES, Section 1506, (i.e., apply retroactively unless the necessary data is not reasonably determinable). Some respondents cited difficulties with applying this requirement to specific industries, namely, rate-regulated enterprises (see discussion under Rate-regulated operations), the real estate industry (see discussion under Practice) and Quebec co-operatives. Quebec co-operatives must follow laws and regulations for this type of enterprise. Certain provisions of the regulations do not conform to GAAP, thereby making it impossible for their financial statements to be issued with an unqualified audit opinion due to the new Accounting Handbook Section.
- 85 The AcSB discussed reasons for diverging from the normal practice of retroactive application, including cost / benefit arguments as well as the possibility that retroactive application may cause a dramatic change in reported equity. The AcSB agreed that the case for rate-regulated operations differs from that for other entities, largely because of the fact that it has an active project underway for rate-regulated operations. The AcSB does not have any plans, however, to change accounting requirements for the real estate industry or Quebec co-operatives that would result in the possibility of a reversal of accounting that might be precluded by Section 1100. For Quebec co-operatives, the AcSB underscored its position in paragraph 1100.12 that if financial statements prepared using a basis of accounting in accordance with regulatory, legislative or contractual requirements conflict with the requirements of Section 1100, that basis of accounting cannot be described as being in accordance with GAAP.
- 86 The AcSB also noted that public companies are sensitive to financial statement restatements. It also noted that the October 1, 2003 effective date would be easier to work with if prospective application was required. As a result, the AcSB agreed to state that the effect of any change in accounting policy made on adopting the new Section should be applied to events and transactions occurring after the date of adoption, and to any outstanding related balances at the date of adoption.

#### **Rate-regulated operations**

- 87 The draft proposals did not include any special treatment for accounting for rate-regulated operations. Some respondents agreed that financial statements prepared in accordance with regulatory or statutory requirements may not be in accordance with GAAP and should not be described as such. However, a number of other respondents expressed concern about the consequences for rate-regulated enterprises. They believe that accounting policies chosen to comply with regulatory or statutory requirements do not reflect a departure from GAAP since they allow for the recognition of a different set of economic circumstances that a rate-regulated enterprise operates within. At a minimum, they believe that a rate-regulated enterprise's financial statements would lose considerable information that is useful for users to predict future income and cash flows (relevance). They claim that while the basis on which these statements are prepared may differ from the basis used by other entities, such a basis is fundamental to the preparation of high-quality, useful financial information and is consistent with the different set of economic circumstances under which rate-regulated enterprises operate. Therefore, they believe that financial statements prepared on this different basis should be considered to be in accordance with GAAP.
- 88 Some respondents argued that there is minimal Canadian guidance regarding rate-regulated accounting and most practitioners refer to pronouncements of the FASB. They argued that some rate-regulated accounting practices are not consistent with existing primary sources of GAAP. Accordingly, they were concerned that rate-regulated accounting is not GAAP because use of US GAAP and industry practices are allowed only if they are consistent with the primary sources of GAAP.
- 89 Some respondents urged that Section 1100 include a temporary exemption for rate-regulated enterprises pending further work by the AcSB on rate-regulated operations. In April 2003, the AcSB began preliminary discussions of the issues raised in the 2002 CICA Research Report, "Financial Reporting by Rate-Regulated Enterprises," with a view to developing a new standard on rate-regulated operations. This project will also consider comments received on the GAAP proposals that pertain to rate-regulated operations.
- 90 The AcSB considered whether to grant temporary relief from the application of Section 1100 to any type of entity. Given the AcSB's active project on rate-regulated operations, members were sympathetic to the fact that such an entity may make changes to adopt Section 1100 and then have to make further changes (perhaps reversing previous decisions) to adopt the future requirements of any CICA Handbook – Accounting amendments related to rate-regulated operations. However, the AcSB expressed concern with a blanket exclusion of rate-regulated operations from Section 1100. The AcSB noted that the specific issues that rate-regulated operations face in applying Section 1100 appear to apply only to those assets and liabilities that are affected by rate regulation. The AcSB did not see a need to provide an exemption from the requirements of Section 1100 for any other aspect of accounting by a rate regulated operation. Furthermore, the AcSB did not have sufficient information to develop a robust definition of a "rate-regulated operation". Many entities undertake both rate-regulated activities, and other activities that are unaffected by rate regulation. The AcSB did not see validity in exempting those activities unaffected by rate regulation.
- 91 Accordingly, the AcSB granted temporary relief from the application of Section 1100 only to the recognition and measurement of assets and liabilities arising from rate regulation, pending completion of a separate project on rate-

regulated operations. Entities are required to apply Section 1100 to all other assets and liabilities for fiscal years beginning on or after October 1, 2003. Entities that choose not to apply Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation must nonetheless comply with all disclosure requirements of GAAP, and disclose the nature, but not necessarily the effect, of the differences between its accounting policies for assets and liabilities arising from rate regulation and those required by the primary sources of GAAP.

#### **CONSEQUENTIAL AMENDMENTS**

- 92 As a consequence of the proposed changes, amendments were made to certain other parts of the CICA Handbook – Accounting. Accounting Handbook Revisions Release No. 24 dated July 2003 provides these consequential amendments, including related explanations.
- 93 The AcSB only considered the necessary changes to the Introduction to Accounting Recommendations and to the Introduction to Accounting Guidelines that result directly from the issuance of GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100, and GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION, Section 1400. The AcSB will perform a more-fundamental review of these Introductions as part of its Accounting Standards Improvements project.
- 94 The AcSB will review and make necessary consequential amendments to the introduction to each Appendix and Illustrative material to clarify its status in accordance with GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, paragraphs 1100.18-.19, in conjunction with its Accounting Standards Improvements project. Until such changes are made, a table posted on the AcSB web site at [www.acsbcanada.org](http://www.acsbcanada.org) (see Completed Projects page for "Generally Accepted Accounting Principles") sets out the authoritative nature of appendices and other material appearing in Accounting Handbook Sections and Accounting Guidelines.

#### **CONSISTENCY WITH US AND INTERNATIONAL REQUIREMENTS**

- 95 In developing this Section, the AcSB has taken into account the hierarchy of US GAAP, as set out in the AICPA's SAS 69, as well as the IASB's International Financial Reporting Standards. The AcSB believes that this Section is not in conflict with the requirements of SAS 69 or the International Financial Reporting Standards.

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## Footnotes

- 1. See "The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles*," American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards No. 69 (SAS 69).
- 2. Generally Accepted Accounting Principles, Exposure Draft, Accounting Standards Board, July 2001.
- 3. Generally Accepted Accounting Principles, Re-exposure Draft, Accounting Standards Board, September 2002.
- 4. The IASB has proposed changes to this guidance in the May 2002 IASB Exposure Draft, "Proposed Improvements to International Accounting Standards," which proposes to move this guidance to IAS 8, "Accounting Policies, Changes in Estimates and Errors."

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