

## Chapter 2 Solutions

Memo

To Canco Ltd.

Subject: Accounting Policies - ASPE and IFRS impact the company and its reporting.

### 1. Frame work

Both ASPE and IFRS provide a frame work for the application of the more detailed accounting principles. The principles are identified in ASPE by subject and handbook section (specific recommendations) and in IFRS by subject and specific recommendations in the pronouncements (IAS – international accounting standard, IFRS – international financial reporting standard).

The exercise of judgment, subject to the principles outlined below, can and does have a significant impact on the recording and reporting function carried out by Canco to reflect the economic results of its operating activities.

ASPE principals are outlined at section 1000 – Financial Statement Concepts

IFRS principals are outlined in the Conceptual framework for financial reporting.

There are both **qualitative and quantitative characteristics** to be considered and applied to the recording of the company's transactions. Understanding what these characteristics are will facilitate the choices that must be made by the company and its management.

### 2. Qualitative Characteristics

IFRS refers to **the qualitative characteristics** that govern the recording and reporting process, the principal characteristics being

- Relevance
- Materiality
- Faithful representation and
- Application of fundamental characteristics

These characteristics influence how the entity will apply **recognition and measurement (quantitative measurements)** to the following key financial statement elements

- Assets
- Liabilities
- Revenues
- Expenses

ASPE at section 1000 defines these **qualitative characteristics** (excerpts) as follows:

Relevance is achieved through information that has predictive value or feedback value and by its timeliness.

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.

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.

These characteristics are applied to the recognition and measurement of the key financial statement elements being: assets, liabilities, revenues and expenses.

IFRS indicates that information must be both relevant and faithfully represented if it is to be useful.

### **3. Accounting Principles for Recording and Measurement (quantitative)**

Bearing in mind the qualitative and quantitative characteristics noted above,Canco needs to implement accounting policies for the recording of Inventory and the recognition and recording of revenues.

ASPE provides the following guidance on the recognition of key financial element and the characteristics that are attached to each.

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. They have three essential

Characteristics:

- (a) they embody a future benefit
- (b) the entity can control access to the benefit; and
- (c) the transaction or event giving rise to the benefit has already occurred.

Revenues are increases in economic resources, resulting from the ordinary activities of an entity. Revenues normally arise from the sale of goods or the rendering of services

Inventory,as it is created and as long as it remains the property of Canco, would constitute an economic resource of the company. Consequently it would be recorded as an asset and be

reflected on the statement of financial position (balance sheet). At the point of a sale the inventory is no longer the asset of the company, it is replaced by another asset, cash or accounts receivable. The key measurement event is then the recognition of the sale. The accounting policy for Cancomust address the point at which Canco would derecognize the inventory asset, record the related cost of sales and recognize the sale. The issues surrounding the recognition of revenues will be examined in greater detail in Chapter 6.

The accounting policies of Cancoshould also address how the company will measure and record the inventory asset as it is created and then held until derecognized on the sale. There are a number of issues surrounding the recording and measurement of inventory that will be addressed in greater detail at chapter 8.

While there are some differences in the rules for ASPE and IFRS ( these will be xplored in the subsequent chapters) regardless of the choice between ASPE and IFRS the objective of the financial reporting process is the same and the fundamental principles that need to be applied are, for the most part, very similar.

The application of those principals, regardless of the choice, will require judgment and that judgment will have a significant impact.In both cases the application of Judgment is a key component, while ASPE states this explicitly and IFRS implicitly, both require it.