

CHAPTER 1

THE CANADIAN FINANCIAL REPORTING ENVIRONMENT

CPA CANADA HANDBOOK

Introduction and Overview:

The CPA CANADA Handbook is composed of the following:

Part I

Accounting, Part I

International Financial Reporting Standards (IFRS)

Part II

Accounting, Part II

Accounting Standards for Private Enterprises (ASPE)

Part III

Accounting, Part III

Accounting Standards for Not-for-profit organizations

Part IV

Accounting, Part IV

Accounting Standards for Pension Plans

Note that the focus of this text is on the first two parts.

Both IFRS and ASPE are required for year-ends beginning on or after 2011. A private enterprise is one that has not issued, and is not in the process of issuing debt or equity instruments that are, or will be, outstanding and traded on a public market. A private enterprise does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

CHAPTER OBJECTIVES

Many students tend to skim through this chapter and, perhaps, dismiss it as of little importance since it does not contain any numbers and debits and credits—the things that they may believe accounting is all about. The chapter, however, provides a good opportunity to stretch their horizons and begin to build their own framework and perspective on this discipline. This can be done by emphasizing the broader role of accounting in society as a source of information about economic activity: that it involves much more than just making bookkeeping entries and deals with measurement and reporting alternatives that have an impact on resource allocation in our society, both at home and internationally. This is also a good time to point out the links between accounting and other courses in their curriculum, such as finance, economics, management, and organizational behaviour.

LEARNING OBJECTIVES

1. Explain how accounting makes it possible to use scarce resources more efficiently.
2. Explain the meaning of “stakeholder” and identify key stakeholders in financial reporting, explaining what is at stake for each one.
3. Identify the objective of financial reporting.
4. Explain how information asymmetry and bias interferes with the objective of financial reporting.
5. Explain the need for accounting standards and identify the major entities that influence standard setting and financial reporting.
6. Explain the meaning of generally accepted accounting principles (GAAP) and the significance of professional judgement in applying GAAP.
7. Discuss some of the challenges and opportunities for accounting.

CHAPTER REVIEW

Financial Statements and Financial Reporting

1. World markets are becoming increasingly intertwined. And, due to technological advances and less onerous regulatory requirements, investors are able to engage in financial transactions across national borders, and to make investment, capital allocation, and financing decisions involving many foreign companies. As a result, an increasing number of investors are holding securities of foreign companies, and a significant number of foreign companies are found on national exchanges.
2. Accounting is a service activity, a descriptive/analytical discipline, and an information system. It may be defined as the process of (1) **identification, measurement, and communication of financial information about (2) economic entities to (3) interested persons**. Its purpose is to help the interested person in making decisions.
3. The focus of this text is on the subset of the accounting discipline known as **financial accounting (financial reporting)**. This subset is concerned with the accumulation of financial information for the purpose of developing financial statements that report on an entity's financial position, the results of operations, and cash flows. The generalized format of these financial statements makes them useful to individuals both internal and external to the enterprise.
4. A principal means of communicating financial information to those outside an enterprise is through **financial statements**: the balance sheet, income statement, statement of cash flows, and statement of owners' or shareholders' equity. Some alternative terminology used in IFRS for financial statement titles are: statement of financial position, statement of comprehensive income, statement of cash flows, and statement of changes in equity.
5. Note disclosure, an important part of each financial statement, must be considered in conjunction with the information provided within the body of the statement. Additional financial information is often provided by means of **financial reporting** through other mechanisms such as the president's letter, supplementary schedules in the corporate annual report, reports filed with government agencies, prospectuses and news releases. Such information may be required by authoritative pronouncements or regulatory agencies or disclosed because management wished to do so voluntarily.
6. The economic activities of a business enterprise represent a complex network of events that shape the financial position, results of operations, and cash flows of that enterprise. However, for those economic activities to be meaningful, they must be identified, measured, organized, and reported on in a manner that effectively serves users' needs. Accounting is the process by which individual economic activities of an enterprise are accumulated into useful financial reports. This information affects perceptions of financial position and success. These perceptions can lead to changes in behaviour and, ultimately, decisions made about the company.

Accounting and capital allocation

7. The fact that markets and free enterprise determine whether a business is successful places a substantial burden on the accounting profession to measure performance accurately and fairly on a timely basis. Investors must be able use the financial information provided to assess risk and relative returns associated with investment opportunities and thereby channel limited resources more effectively. In Canada, the primary exchange mechanisms for allocating resources are debt markets, equity markets, and financial institutions.
8. An effective processing of **capital allocation** promotes productivity, encourages innovation, and provides an inefficient liquid market for buying and selling securities and obtaining and granting credit. When information is unreliable and irrelevant, poor capital allocation results.

Stakeholders

9. **Stakeholders** are those who have something to risk as a result of financial reporting such as their jobs, salaries, investments, or reputation. Key stakeholders include traditional users of financial information (investors and creditors) who rely directly on the financial information for resource allocations. In broader terms, stakeholders include these traditional stakeholders as well as those who help in the **efficient** allocation of resources such as financial analysts, auditors, unions, industry groups, customers, employees, and regulators who review, audit and monitor information. Stakeholders also include management, the preparer of financial information.

Objective of Financial Reporting

10. The objective of general-purpose financial statements is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
 - a. **General-purpose financial reporting is to** provide at the least cost the most useful information possible to a wide variety of users.
 - b. **Capital providers (investors)** are the primary user group and have the most critical and immediate need for information in the financial statements. Investors need this information to assess a company's ability to generate net cash inflows and to understand management's ability to protect and enhance the assets of a company.
 - c. The **entity perspective** means that the company is viewed as being separate and distinct from its creditors and owners (shareholders). Therefore, the assets of the company belong to the company, not a specific creditor or shareholder. Financial reporting focused only on the needs of the shareholder—the **proprietary perspective**—is not considered appropriate.

- d. Decision-usefulness means that information contained in the financial statements should help investors assess the amounts, timing, and uncertainty of prospective cash inflows from dividends or interest, and the proceeds from the sale, redemption, or maturity of securities or loans. In order for investors to make these assessments, the financial statements and related explanations must provide information about the company's economic resources, the claims to those resources, and the changes in them.
11. Information generated using the **accrual basis** of accounting provides a better indication of a company's present and continuing ability to generate favourable cash flows than the **cash basis**.

Information Asymmetry

12. Ideally, to facilitate the flow of capital in the most efficient and effective manner, all stakeholders should have equal access to all relevant information. In other words, there should be symmetry of access to information (**information symmetry**). This is nice in theory but it does not always work in practice. Management may feel that disclosure of all information may hurt the company's competitive advantage or position. For this reason, (and others), perfect information symmetry does not exist and as a general rule, management rightly has access to more information than others since they run the company. In other words, there is **information asymmetry**. Accounting and economic theory tries to help us understand these issues. The **efficient markets hypothesis** proposes that market prices reflect all information about a company. There are two common types of information asymmetry problems that are studied by academics: adverse selection and moral hazard.
- a. **Adverse selection** — This means that where information asymmetry exists, the capital marketplace may attract the wrong type of company; that is, those companies that have the most to gain from not disclosing information.
 - b. **Moral hazard** — This concept refers to human nature and notes that people will often shirk their responsibilities if they think that no one is watching, which encompasses the prejudices of **management bias**, **aggressive accounting** and **conservative accounting**. Any bias in financial reporting results in less useful information.
13. The financial statements that result from the accounting process are based upon a conceptual framework and accounting standards developed by the accounting profession. The accounting profession has attempted to provide a body of accounting theory and practice that is generally accepted and applied. This body of accounting theory and practice serves to promote comparability in the preparation and analysis of financial statements. The accounting profession in each country, including Canada, has developed a common set of accounting concepts, standards, and procedures known as **generally accepted accounting principles (GAAP)**. GAAP serves as a guide to the accounting practitioner in accumulating and reporting the financial information of a business enterprise. The ultimate adoption of some generally accepted accounting principles has caused controversy among accountants as well as members of the financial community. However, a majority of the members in each group recognizes the ultimate benefit an accepted set of accounting principles can bring to the financial reporting process.

Standard Setting

14. The organizations that are responsible for developing financial reporting standards in Canada include:
 - a. Canadian Accounting Standards Board (AcSB);
 - b. International Accounting Standards Board (IASB);
 - c. The Financial Accounting Standards Board (FASB) and the Securities Exchange Committee (SEC); and
 - d. Provincial securities commissions such as the Ontario Securities Commission (OSC).
15. The objectives of the AcSB are as follows:
 - a. To establish financial reporting standards and guidance that improve the quality of information reported by Canadian entities, principally annual and interim general purpose financial statements, with due consideration for the costs and the benefits to the preparers and users of financial statements of different categories of reporting entity, and changes in the economic environment.
 - b. To facilitate the capital allocation process in both the business and not-for-profit sectors through improved information.
 - c. To participate with other standard setters in the development of a single set of high quality internationally accepted financial reporting standards.
 - d. To support the implementation of financial reporting standards and the resolution of emerging application issues.

The **Accounting Standards Oversight Council (AcSOC)** oversees AcSB activities.

16. The AcSB has historically been responsible for setting standards for public and private entities as well as not-for-profit entities (including some profit-oriented government entities). From 2011 onward, the AcSB is responsible for developing standards for private enterprises, not-for-profit entities, and pension plans only as these three groups do not generally operate in global markets and are simple business models. Private companies that are global and complex may choose to follow IFRS (particularly if they are planning in the future to go public). Standards for publicly accountable entities (public companies) will be set by the International Accounting Standards Board.
17. In 2001, a new International Accounting Standards Board (IASB) was created. Its aims are as follows:
 - a. To develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions.
 - b. To promote the use and rigorous application of those standards.
 - c. In fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the needs of a range of sizes and types of entities in diverse economic settings.
 - d. To promote and facilitate adoption of International Financial Reporting Standards (IFRSs), being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

18. The international standard-setting structure is composed of four organizations: The **International Accounting Standards Committee Foundation (IASCF)**, the **International Accounting Standards Board (IASB)**, a **IFRS Standard Advisory Council (SAC)**, and an **International Financial Reporting Interpretations Committee (IFRIC)**.
- The trustees of the IASCF select the members of the IASB and the SAC, fund their activities, and oversee the IASB's activities.
 - The IASB develop, in the public interest, a single set of high-quality and understandable IFRS for general-purpose financial statements. The IASB relies on the expertise of various task force groups formed for various projects and on the SAC.
 - The SAC consults with the IASB on major policy and technical issues and also helps select task force members.
 - The IFRIC acts as the "problem filter" for the IASB, leaving the IASB to work on more pervasive long-term problems. It addresses controversial accounting problems as they arise, and determines whether it can quickly resolve them or whether to involve the IASB in solving them.
19. The IASB has a thorough, open and transparent **due process** in establishing financial accounting standards. It consists of the following elements:
- An independent standard-setting board overseen by geographically and professionally diverse body of trustees.
 - A thorough and systematic process for developing standards.
 - Engagement with investors, regulators, business leaders, and the global accountancy profession at every stage of the process.
 - Collaborative efforts with the worldwide standard-setting community.
20. To implement its due process, the IASB follows specific steps to develop a typical IFRS:
- Topics are identified and placed on the Board's agenda.
 - Research and analysis are conducted and **discussion papers** are issued on the preliminary views of pros and cons.
 - Public hearings are held on the proposed standard.
 - Board evaluates research and public response and issues an **exposure draft**.
 - Board evaluates responses and changes exposure draft, if necessary. Then final standard is issued.
21. The following characteristics of the Board are meant to insulate its members as much as possible from the political process, favoured industries, and national or cultural bias:
- Membership:** The Board consists of 14 members, from 7 different countries, serving 5-year renewable terms. Up to three members may be part-time.
 - Autonomy:** The IASB is not part of any professional organization. It is appointed by and answerable only to the IASCF.
 - Independence:** Full-time members must sever all ties with their former employer. Members are selected for their expertise rather than to represent a given country.
 - Voting:** Nine of 14 votes are needed to issue a new IFRS.

22. The IASB issues three major types of pronouncements:
- International Financial Reporting Standards:** To date the IASB has issued 13 IFRS standards. In addition, the previous international standard-setting body, the **International Accounting Standards Committee (IASC)** issued 41 **International Accounting Standards (IAS)**. Those that have not been amended or superseded are considered under the umbrella of IFRS.
 - Framework for Financial Reporting:** The IASC issued the **Framework for the Preparation and Presentation of Financial Statements** (referred to as the Framework) with the intent to create a conceptual framework that would serve as a tool for solving existing and emerging problems in a consistent manner. However, the Framework is not an IFRS and does not define standards for any particular measurement or disclosure issue. Nothing in the Framework overrides a specific IFRS.
 - International Financial Reporting Interpretations:** Interpretations are issued by the IFRIC and are considered authoritative and must be followed. Seventeen have been issued to date. These interpretations cover (1) newly identified financial reporting issues not specifically dealt with in IFRS, and (2) issues where unsatisfactory or conflicting interpretations have developed, or seem likely to develop, in the absence of authoritative guidance.
23. The IASB has no regulatory mandate and no enforcement mechanism. It relies on other regulators to enforce the use of its standards. For example, the European Union requires publicly traded member country companies to use IFRS. Any company indicating that it prepares its financial statements in conformity with IFRS must use all of the standards and interpretations. The hierarchy of authoritative pronouncements is: IFRS, IAS, Interpretations issued by either the IFRIC or its predecessor the SIC, the requirements and guidance in standards and interpretations dealing with similar and related issues, the Framework, and most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards.
24. In the United States, the **Financial Accounting Standards Board (FASB)** is the major standard-setting body, although it does not have final authority over standards—instead, the **Securities and Exchange Commission (SEC)** does. The SEC has confirmed its support for the FASB by stating that financial statements that conform to FASB standards will be presumed to have substantial authoritative support. U.S. GAAP has and will continue to have a significant impact on GAAP in Canada. First, since Canadian GAAP is based on principles and is fairly open to interpretation, accounting professionals have often relied on the more prescriptive, specific guidance provided in U.S. GAAP. Second, many Canadian companies are also listed on U.S. stock markets and exchanges.
25. Provincial Securities Commissions have laws and legislation that require companies that issue shares to the public and the shares are traded on a Canadian stock exchange must produce GAAP financial statements. Stock exchanges, as well as securities commissions, have the ability to fine a company and/or delist the company's shares so compliance with GAAP is mandatory.

Generally Accepted Accounting Principles (GAAP)

26. GAAP includes **not only specific rules, practices, and procedures** for particular circumstances **but also broad principles and conventions that apply generally**, including underlying concepts.
27. As mentioned previously, GAAP is the standard followed by public companies, private companies, pension plans, and not-for-profit entities. GAAP is divided into primary and other sources. The primary sources must be looked at first, but if a primary source does not specifically address an issue, the entity must use accounting policies that are consistent with the primary source through the use of professional judgement and in accordance with the conceptual framework embodied in the relevant Part of the *CPA Canada Handbook*.
28. For public companies, the primary sources of GAAP incorporate:
 - a. International Financial Reporting Standards (IFRS),
 - b. International Accounting Standards (IAS), and
 - c. Interpretations (IFRIC)
9. Under ASPE, the GAAP hierarchy requires users to consider first the *Handbook, Part II*, Sections 1400 to 3870, including appendices and second, Accounting guidelines, including appendices. These are the primary source of GAAP. Other sources are noted in Section 1100 of the *CPA Canada Handbook, Part II* and include Background information and basis for conclusion documents issued by the AcSB; AcSB implementation guidance; pronouncements; Approved drafts of previously non-existent primary sources; research studies, accounting textbooks, journals, studies, and articles; and other sources such as industry practices.

Professional Judgement

30. While IFRS and ASPE provide important guidance, the resolution of many issues regarding financial statement reporting for particular companies and circumstances must still rely heavily on the exercise of **professional judgement**. Professional judgement plays an especially important role for Canadian and international accountants due to the basic philosophy that there **cannot be a rule for every situation**. Professional judgement reflects the ability to make an appropriate decision regarding unfamiliar and changing situations. Exercising professional judgement requires a thorough knowledge and understanding of IFRS and ASPE and reflects education, experience, and ethics.

Challenges and Opportunities for the Accounting Profession

31. The financial reporting environment is changing rapidly. Government regulation in the capital marketplace has increased due to some major corporate scandals. The Sarbanes-Oxley Act (SOX) enacted in 2002 gave the SEC more resources to fight fraud and poor reporting practices. In addition, an accounting oversight board (Public Company Accounting Oversight Board) was established and given oversight and enforcement authority. In Canada, stronger independence rules, management accountability measures, and codes of ethics for financial officers were put in place. Essentially the effect of these measures has put more emphasis on government regulation and less on self-regulation.
32. Because accounting information is to help in decision-making, it can influence behaviour. Consequently, **ethical behaviour** by accountants is crucial to maintaining the integrity of the accounting profession. In accounting, ethical dilemmas are encountered frequently. The steps that may help in the process of developing ethical awareness and resolving ethical dilemmas are as follows:
 - a. Recognize an ethical situation or ethical dilemma.
 - b. Move towards an ethical resolution by identifying and analysing the principal elements in the situation.
 - c. Identify the alternatives and weigh the impact of each alternative on various stakeholders.
 - d. Select the best or most ethical alternative considering all the circumstances and the consequences.
33. While politics influences the development of standards, this is not necessarily a bad thing given the economic impact of those standards implemented. Nonetheless, politics should not be the main motivation for standard setting. Special interest groups are other stakeholders that will fight to get what they want as well. As more and more countries adopt IFRS, diverse political climate, as well as other cultural, economic, social and legal needs of the countries involved will need to be considered in the standard setting process.
34. A key issue with standard setters in various jurisdictions is the **principles versus rules** debate regarding GAAP.

U.S. GAAP has historically been more prescriptive (even though it is based on principles) and thus has leaned toward the rules-based approach. **In a rules-based approach—much like the Canadian tax system**—there is a rule for most things (even though the rule may be based on a principle). The result is that the body of knowledge is significantly larger. Unfortunately, the rules-based approach does not always emphasize the importance of communicating the best information for users.

IFRS and ASPE are more principles-based. The body of knowledge is smaller and the idea is that one or more principles form the basis for decision-making in many differing scenarios. In addition, professional judgement is fundamental. There is less emphasis on right and wrong answers. Rather, the financial reporting is a result of carefully reasoned application of the principle to the business facts. In a principles-based body of knowledge, bright-line tests are minimized. **Bright-line tests** are numeric benchmarks for determining accounting.

35. Other changes in the financial reporting environment are characterized by the following:
- a. Globalization of companies and capital markets results in a greater need for comparability of financial information across different countries.
 - b. As technology continues to advance, the need for timely information is rising sharply. A continuous reporting model is already under discussion in the capital markets arena.
 - c. Increased requirement for accountability. This has in part been brought on by the increase in institutional investors who have greater investment knowledge and representation on corporate boards. In addition CPA Canada has several initiatives dealing with risk management, governance, and performance reporting that take a broader view of an all-inclusive business reporting.
36. **Integrated reporting** is a term that incorporates aspects of financial reporting as well as measurements used by management to evaluate the business (including non-financial information) and information regarding opportunities and risks, critical success factors, management and shareholders, and background about the company. Business reporting can also include reports on environmental matters, human resources, or technological issues. The Balance Scoreboard model takes financial, customer, internal processes, and learning and growth perspectives of a company to help a company achieve its strategic vision by developing objectives within each perspective.

LECTURE OUTLINE

The material in this chapter can usually be covered in one class session. The issues in this chapter may be addressed by organizing a lecture around the following questions.

A. What is accounting?

1. **Recognition, measurement, and disclosure (communication)** of financial information (discuss difference between financial statements, financial reporting, and business reporting).

TEACHING TIP

Illustration 1-1 can be used to identify the essential characteristics of accounting, financial statements, financial reporting, and business reporting.

- a) Financial statements:
 - i. Income Statement
 - ii. Balance Sheet
 - iii. Statement of Cash Flows
 - iv. Statement of Owners' or Shareholders' Equity
- b) Financial reporting:
 - i. President's Letter and Management's Discussion and Analysis
 - ii. Prospectuses
 - iii. Reports filed with security commissions and other government agencies
 - iv. News releases
- c) Business reporting:
 - i. Financial and non-financial data
 - ii. Management's analysis
 - iii. Forward looking information (forecasts)
 - iv. Information about management and shareholders
 - v. Background about the company

Note: While business reporting provides insight into the broad information needs of stakeholders, the focus of financial accounting and auditing is on information reported in financial statements.

2. About economic **entities** (discuss types of entities: corporations, partnerships, and proprietorships).
3. For **interested parties** (discuss shareholders, creditors, government agencies, management, employees, consumers, labour unions, etc.).

B. What is the objective of financial statements?

Based on *CPA Canada Handbook, Part II*, Section 1000 on "Financial Statement Concepts," the objective of financial statements is to:

. . . communicate information that is useful to investors, creditors and other 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.

This statement is consistent with many statements of objectives (e.g., FASB, CPA Canada, The International Accounting Standards Committee). All reflect the underlying theme that the objectives of financial statements are to:

- 1. Provide information that is **useful** to present and potential **investors, creditors, and other users** in making rational investment, credit, and similar decisions;
- 2. To provide information to help present and potential investors, creditors, and other users in **assessing the amounts, timing, and uncertainty** of prospective **cash receipts** from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans; and
- 3. To provide information about the **economic resources** of an enterprise, the **claims** on those resources, and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

C. What is the nature of the environment in which accounting operates?

- 1. A world of scarce resources. Accounting helps to identify efficient and inefficient users of resources.
- 2. A society of legal and ethical concepts of property and other rights. Accounting recognizes these concepts in determining equity among the varying interests in a business entity.
- 3. An economic system in which owners and investors entrust the custodianship of and control over property to managers. The **stewardship function** of accounting is fulfilled by providing reliable, relevant, comparable financial data for owner-manager use (i.e., where funds came from, what funds were used for, what were the results of their use—an accountability report).
- 4. An economic system consisting of various groups having different interests in a business. All interest groups seek information about the business. Consequently, there are many diverse users and uses for financial statements.

5. An economic system in which economic activity is continuous and interdependent over time. Accounting statements, however, divide activities into particular time periods resulting in the need to make predictions about and estimates regarding the future.
 6. An economic structure in which economic activity is conducted by separately identifiable business enterprises.
 7. An economic system that requires monetary measures of enterprise events that affect economic resources, obligations, and residual interests.
- D. Why are **ethics** a crucial aspect of accounting?
1. Accounting information can influence behaviour (decision making).
 2. Accounting information needs to be fair and unbiased.
 3. Because estimates and judgements are required and there are significant pressures that may tempt to sway these estimates and judgements into certain directions, accountants must always act ethically in doing their job. Without an ethical focus, the integrity of financial statement information would be non-existent.
- E. Why are **generally accepted accounting principles (GAAP)** needed?
1. Because of the need for comparability, fairness, and understandability.
 2. To minimize management bias, ambiguity, inexactness, and misinterpretation.
- F. What constitutes GAAP?

The *CPA Canada Handbook* states that GAAP "encompasses not only specific rules, practices, and procedures relating to particular circumstances but also broad principles and conventions of general application, including underlying concepts." This definition is interpreted to mean that GAAP includes:

The Conceptual Framework

- objectives; qualitative characteristics of information; definitions of elements of financial statements; recognition and measurement guidelines; assumptions, principles, and constraints.

For private companies, pension plans, and not-for-profits, GAAP is divided into primary sources and other sources. Discuss the primary sources (*CPA Canada Handbook, Part II*, Sections 1400 to 3856 including appendices and Accounting Guidelines, including appendices), and other sources. Discuss how these primary and secondary sources are applied (i.e. a secondary source is used when specific issues are not dealt with directly in a primary sources, however the secondary source must be consistent with primary sources, developed by applying professional judgement in accordance with Section 1000 concepts).

For public companies, IFRS will be followed, but the concepts are similar. Note that footnote 17 states: “Technically, IFRS will be considered to be part of the Canadian *CPA Canada Handbook* for legal reasons although the CPA Handbook as it relates to IFRS will exactly mirror the IASB standards. This was done as an interim measure as many Canadian laws refer to Canadian GAAP. At some point, these laws will be amended to reflect the fact that GAAP for public companies in Canada is IFRS per the IASB.” This should help clarify for students that the shift to IFRS has been an ongoing harmonization process and that Canadian GAAP will not greatly differ in crucial areas from IFRS.

G. Who has authority to set standards?

The Accounting Standards Board (AcSB) of CPA Canada is responsible for the financial accounting recommendations in the *CPA Canada Handbook*. Discuss the **due process** system for both Canadian and International standards.

TEACHING TIP

Use Illustration 1-7 in the text to illustrate the evolution of New or Revised Canadian Standards. Refer to Illustration 1-8 in the text to illustrate the evolution of a new or revised International financial reporting standard respectively. Have students compare the two processes for similarities and differences.

H. How are standards enforced?

1. *CPA Canada Handbook* recommendations have legal status and, as such, violation could result in court proceedings and judgements.
2. Auditor's examination of financial statements related to rendering an auditor's report.
3. Professional codes of ethics.
4. Securities exchange requirements.
5. Reporting requirements of banks for accessing credit.
6. General acceptance.

I. Why are various groups interested in accounting?

TEACHING TIP

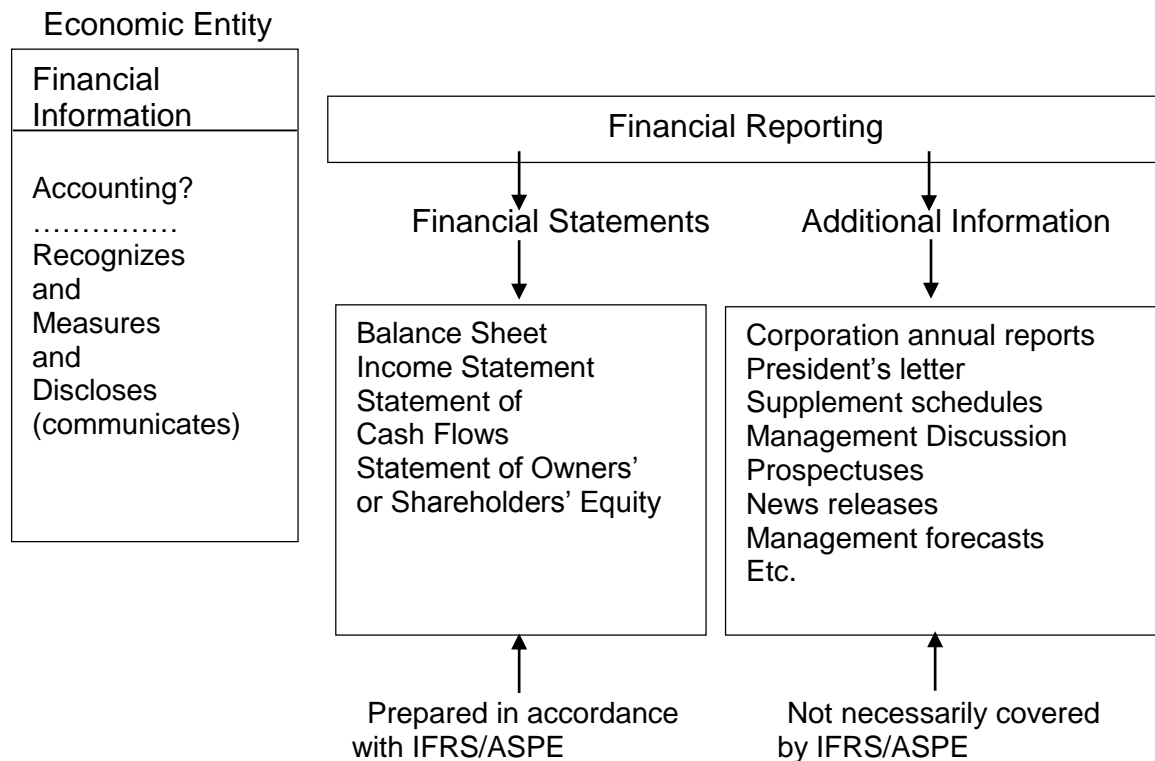
Illustration 1-2 can be used to discuss the major groups that are influential in the standard setting process.

1. Describe these groups, their composition and their interests.
2. Discuss the impact of accounting on the interests of each group.

3. Discuss the impact of these groups on accounting.
- J. What is the role of government in standard setting?
1. Through the CBCA, development of standards has been left with the profession through the AcSB's development of the *CPA Canada Handbook*.
 2. Discuss the Enron scandal as a major event that challenged the viability of the capital market system. The end result was to increase government regulation in the marketplace. In 2002, the SEC approved new auditor independence rules and materiality guidelines for financial reporting. The Sarbanes-Oxley Act was signed into law.
 3. Consider the Macdonald Commission report and its possible consequences.

ILLUSTRATION 1-1

THE ESSENTIAL CHARACTERISTICS OF ACCOUNTING, FINANCIAL REPORTING, AND ELEMENTS NEEDED TO ACHIEVE A SINGLE SET OF HIGH-QUALITY ACCOUNTING STANDARDS

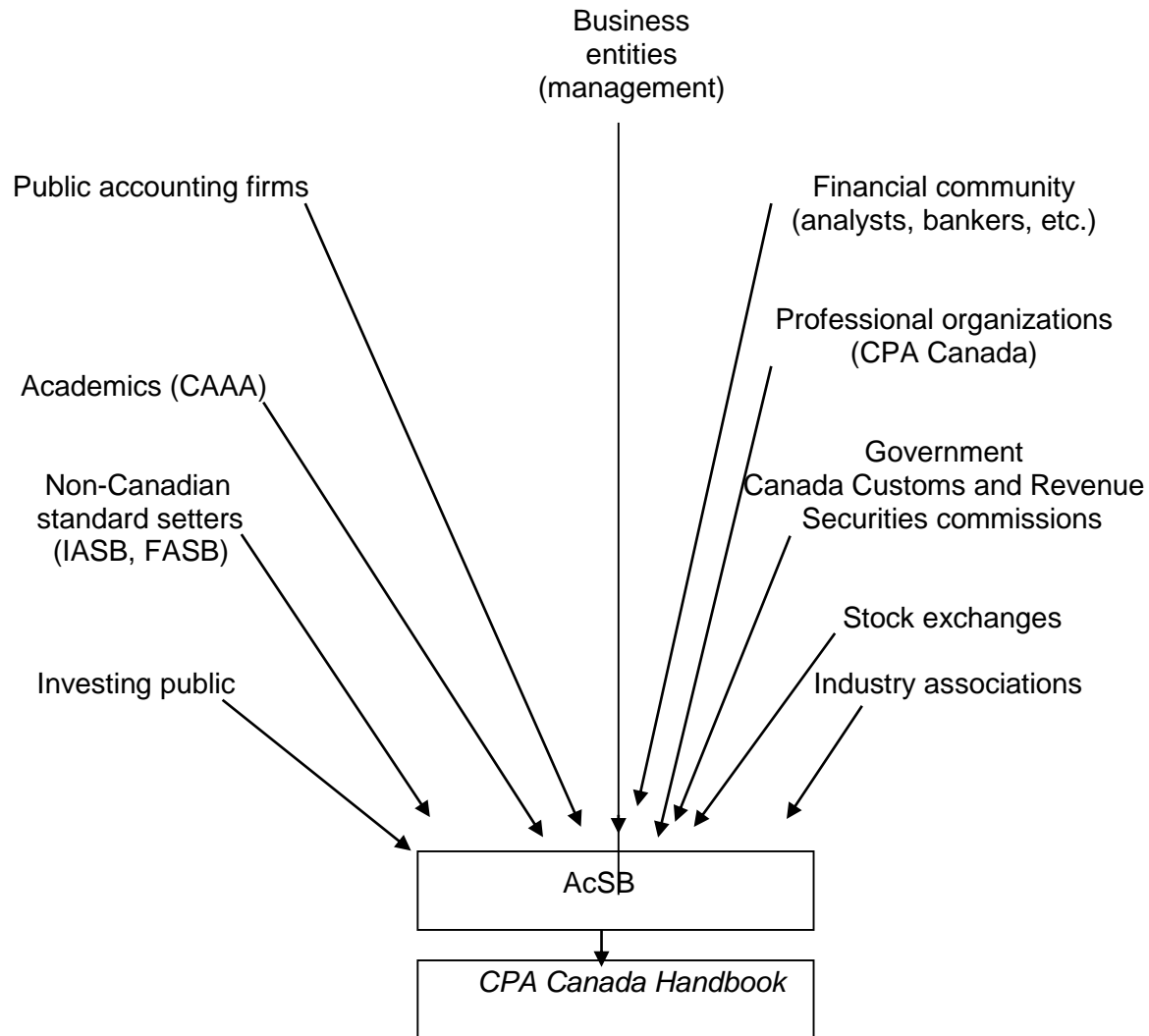


Elements of High-Quality Accounting Standards

- A single set of high-quality accounting standards established by a single standard setting body
- Consistency in application and interpretation
- Common high-quality auditing standards and practices
- Common approach to regulatory review and enforcement
- Education and training of market participants
- Common delivery systems
- Common approach to corporate governance and legal frameworks around the world.

ILLUSTRATION 1-2

USER GROUPS THAT ARE INTERESTED IN AND CAN INFLUENCE THE FORMULATION OF ACCOUNTING STANDARDS



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