The Clear-Cut: ASPE

Disclosure of Accounting Policies and Accounting Policy Changes

When preparing financial statements in accordance with Accounting Standards for Private Enterprises (ASPE) a common scenario is determining whether or not an identified issue is either a change in accounting policy, a change in accounting estimate or a prior period error. Section 1506 *Accounting Changes* is the handbook section that provides guidance on these matters including the relevant disclosure requirements.

In this Clear-Cut we will explore the requirements for the disclosure of accounting policies as well as the guidelines for making accounting policy changes.

Disclosure of Accounting Policies

ASPE Section 1505 *Disclosure of Accounting Policies* states that a clear and concise description of the significant accounting policies of an enterprise shall be included as an integral part of the financial statements. An accounting policy is defined as being a specific principle, basis, convention, rule or practice applied by an entity in preparing and presenting financial statements.

2017 Annual Improvements to ASPE

Previously, Section 1505 was very specific in that it required the disclosure of accounting policies in the "first note" to the financial statements. However, due to the common practice of including a nature of operations disclosure as the first note this requirement was relaxed in the 2017 Annual Improvements to ASPE. The revised requirement is for the disclosure of accounting policies to be "in one of the first notes" to the financial statements.

While it is encouraged that an entity should identify and describe any accounting policies that are significant to its operations the minimum disclosure requirements relate to information on areas where judgment has been exercised. At a minimum, disclosure of information on accounting policies shall be provided when:

- A selection has been made from alternative acceptable accounting principles and methods; or
- There are accounting principles and methods used that are peculiar to an industry.

Some accounting policies are specifically required by other sections of ASPE such as revenue recognition (3400.31) and inventory costing (3031.35(a)).

To help illustrate some examples of where a selection has been made from alternative acceptable accounting principles and methods we have prepared a non-exhaustive listing of the most common situations for private enterprises.

Relevant Accounting Policy	Alternative Acceptable Accounting Principles
Method of costing inventory (i.e. cost formulas)	• Weighted average cost • First-in-first-out (FIFO) • Specific identification
Method of accounting for a subsidiary	• Consolidation • Equity method • Cost method
Method of accounting for an investment subject to significant influence	• Equity method • Cost method
Method of accounting for jointly controlled enterprises	• Equity method • Cost method • Accounting for rights to the individual assets and obligations for the individual liabilities
Method of accounting for income taxes	• Future income taxes (FIT) method • Taxes payable method
Method of amortizing property, plant and equipment	• Straight-line method • Decreasing charge method (i.e. declining balance method) • Variable charge method (i.e. hours of use or units of production)

Accounting Policy Changes

In general, an entity may only change an accounting policy in one of two scenarios:

1. If the change is required, such as in the event of a new or revised accounting standard; or
2. When the change results in financial statements that provide more reliable and relevant information about the entity's financial position, financial performance or cash flows.

Notwithstanding the above, there is a list of exceptions within ASPE that permit an entity to change an accounting policy regardless of whether or not it improves the quality of the information within the financial statements. The exceptions are as follows:

- account for subsidiaries using consolidation, equity method or cost;
- account for investments subject to significant influence using equity method or cost;
- account for jointly control enterprises using equity method, cost or by accounting for rights to the individual assets and obligations for the individual liabilities;
- capitalize or expense expenditures on internally generated intangible assets during the development phase;
- measure a defined benefit obligation for which an appropriate funding valuation has been prepared using that funding valuation or a separate actuarial valuation prepared for accounting purposes;
- account for income taxes using the taxes payable or the future income taxes methods; and
- measure the equity component of a financial instrument that contains both a liability and an equity component at zero.

Retrospective vs. Prospective Application

A change in accounting policy is addressed using either retrospective or prospective application. When applying a new or revised standard the accounting is applied based on the guidance of that new or revised standard which may either be retrospective or prospective. When a change in an accounting policy is not due to a new or revised standard then that change must be accounted for retrospectively.

Disclosure of Initial Application of a New or Revised Standard

When initial application of a new or revised standard has an effect on the current period or any prior period the following must be disclosed in the financial statements:

a) the title of the new or revised standard;
b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
c) the nature of the change in accounting policy;
d) when applicable, a description of the transitional provisions;
e) for each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;
f) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
g) if retrospective application is required but is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

2017 Annual Improvements to ASPE

The disclosure requirements for both initial application and voluntary changes were recently revised via the 2017 Annual Improvements to ASPE. Previously the disclosure requirements related to the amount of the adjustment in paragraphs (e) above and (c) below were for the 'current period' which required additional calculations to determine the impact on the current period's figures. The revised requirement is for 'each prior period presented' which is less onerous since the calculations are required to be made for the retrospective adjustments anyways.

Disclosure of a Voluntary Change

When a voluntary change in accounting policy has an effect on the current period or any prior period or would have an effect on that period except that it is impracticable to determine the amount of the adjustment, an entity shall disclose:

a) the nature of the change in accounting policy;
b) the reasons why applying the new accounting policy provides reliable and more relevant information, unless an accounting policy choice was permitted under the exemptions in which case the entity shall explain why it made the accounting policy choice;
c) for each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;
d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Example of a Disclosure of a Voluntary Change

Included in Appendix A below is an example of disclosure for an accounting policy change. In this example the Company has elected to change its accounting policy for measuring the cost of its inventories for its year ended December 31, 20X1. Included in the disclosure is the nature of the change in the accounting policy, the reason why management elected to make the change, and the amount of the adjustment to each financial line item effected for the comparative period.

Appendix A - Example Disclosure of Accounting Policy Change

Note X - Change in Accounting Policy for Inventories

Effective January 1, 20X1 the Company changed its accounting policy to measure the cost of its inventories using the first-in first-out method. Previously, the Company measured the cost of its inventories using weighted average cost.

The change in policy has been made because it is management's opinion that the first-in first-out method more accurately reflects the flow of the Company's inventories.

Below is a summary of the impact of the change in policy for the previous year.

	December 31, 20X0 As previously reported	Adjustment	December 31, 20X0 Restated amount
Inventory	$ 378,998	$ 28,726	$ 407,724
Income Taxes Payable	6,929	3,734	10,663
Cost of Goods Sold	1,342,576	(28,726)	1,313,850
Income Taxes	13,857	3,734	17,591
Net Income	92,733	24,992	117,725
Retained Earnings	1,049,572	24,992	1,074,564