
Business Report



Canadian GAAP for Private Enterprises November 2010

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Changes are coming for preparers of Canadian Generally Accepted Accounting Principles (GAAP) financial statements. When International Financial Reporting Standards (IFRS) arrives in Canada in January 2011, there will be several acceptable systems for preparing financial statements. GAAP will no longer be available. Most companies will apply either the new Accounting Standards for Private Enterprises (ASPE) or IFRS.

At this time, two types of financial statements are not expected to change much:

- Financial statements compiled only for tax filing purposes
- Not-for-Profit enterprises are NOT required to decide between IFRS and ASPE. The Canadian Institute of Chartered Accountants expects to provide additional guidance for Not-for-Profits sometime in 2010.

ASPE or IFRS?

If you are a private enterprise that prepares general purpose financial statements and you are not a publicly-accountable entity¹, you are going to have to choose between ASPE and IFRS. Your choice is “all-or-nothing” – you may only apply accounting policies available under IFRS or those available under ASPE.

Which GAAP makes the most sense for you? We expect that most companies that have a choice will choose ASPE. It is less complex, is more similar to GAAP, and requires less effort to transition than IFRS. ASPE is designed for the needs of lenders rather than the needs of the public capital markets.

Nevertheless, IFRS may be a better choice for those enterprises:

- with a number of “distant” equity investors;
- with foreign parents or subsidiaries that report under IFRS;
- with users (including lenders) that prefer IFRS;
- that want to keep options open for eventual public equity financing or take-outs; or
- where competitors for capital, customers, or talent use IFRS.

Timing

ASPE applies for the first set of financial statements with years beginning on or after January 1, 2011.

There is an option for 2010 or even 2009 reporting. Earlier adoption makes sense in certain circumstances. ASPE is easier, in some cases a lot easier, on financial statement note disclosures. Where disclosures are extensive, early ASPE adoption could help. Of course, the trade-off is earlier effort required to understand the new standards and to make any changes.

¹ Public accountability considers the number and diversity of stakeholders (including investors, lenders, shareholders, and other beneficiaries) and their interests in an enterprise. Public companies will be required to apply IFRS.

Possible Accounting Changes

GAAP was the starting point for ASPE. In many areas, accounting will continue as usual though disclosures may be simplified. Many financial statements will change because of the following differences between GAAP and ASPE:

- Differential Reporting – Certain simplifications available under GAAP are now part of ASPE-GAAP – for example - preferred shares issued in tax planning arrangements will now be classified as equity. Other simplifications remain as policy choices.
- Differential reporting enterprises will no longer have to obtain unanimous shareholder approval or make related representations and disclosures in their financial statements.
- Financial Instruments – Under ASPE all financial instruments will be measured at amortized cost except for equity securities quoted in an active market (measured at fair value) and free-standing derivatives that are not part of a qualifying hedging arrangement (also measured at fair value). There is an interesting new option to irrevocably elect fair value measurement at inception of any financial instrument.

Companies with accounting or disclosures in the following areas will also see major changes: stock-based compensation; employee future benefits; development costs; goodwill; and asset retirement obligations.

Accounting for callable debt and leases, two areas that have historically been problematic for some, are unchanged from existing GAAP.

First Year of ASPE

If you are a calendar year-end company, your December 31, 2011 financial statements must be in either ASPE or IFRS. Your December 31, 2010 comparative financial statements must also follow the chosen system. Effectively, you will prepare two sets of December 31, 2010 financial statements - under existing GAAP (this year) and the chosen system (next year for comparative purposes).

If you are a calendar year company, your starting point for conversion to ASPE is a transition balance sheet as at January 1, 2010. Your ASPE transition balance sheet is prepared as if you had always applied ASPE. You may save time or re-set balances to amounts that are more meaningful by opting for certain available exemptions.

Choices that could have major effect for most companies include:

- Fair value re-set – any item of property, plant and equipment may be recorded at fair value on the transition balance sheet.
- Financial instruments – any financial instrument may be designated to be measured at fair value.

If you are a calendar year-end company and you are considering these options, you will need fair value data as at January 1, 2010. Now is a good time to be thinking about this!

Choices are also available, and may be applicable, in the following areas: convertible debt; business combinations; employee future benefits; cumulative translation adjustment account; and asset retirement obligations.

You will need to make additional disclosures in the transition year to help bridge your users from GAAP to ASPE. Additions include details of each adjustment made to opening retained earnings for the transition as well as a reconciliation of GAAP income to ASPE income for the comparative year. You are required to disclose the ASPE transition balance sheet in your first set of ASPE financial statements.

Income Tax

Taxable enterprises should be alert for intended and unintended tax consequences of changes, including changes in tax reporting. Your required T2S-1 reconciliation of accounting income to taxable income will change; it will probably be more complex.

Other Considerations

Canadian accounting standard setters intend to update ASPE approximately every two years. Updates will consider changes to IFRS during the period.

Should you choose ASPE now, it is possible to convert to IFRS at some point in the future. Some of the main issues in conversion include:

- Transition year reporting – statements will need to be prepared under both systems for one year, and an IFRS opening balance sheet will need to be prepared and disclosed.
- Accounting changes – property, plant and equipment; revenues; investment properties; provisions and contingencies; income taxes; stock-based compensation; employee future benefits; financial instruments; and related party transactions.
- Financial statement disclosures – IFRS financial statements are presented differently. They could be several times as long as ASPE statements. In addition to more extensive disclosures in many areas, IFRS requires new disclosures (e.g. corporate information including compensation of key management personnel).

Summary

Your ASPE financial statements will almost certainly have different numbers and note disclosures compared to current statements. Bank lending agreements, bonding company requirements, shareholder buy/sell agreements, government grants or funding arrangements, compensation and bonus arrangements, and other agreements with GAAP references may be impacted. For this reason, we suggest you internally “convert” the last year of GAAP statements (2010 for calendar year-ends) sooner rather than later to ASPE or IFRS so that there is time to adjust agreements to your new accounting reality.

Now is a good time for you to consider the changes and choices needed for ASPE. Your professional advisor at D&H Group LLP would be pleased to help you with this process.

D&H Group LLP continues to keep you informed of changes (and proposed changes) that can affect you and your business. D&H Group LLP is an eighty person firm with over 50 years experience in providing clients with sound professional advice. We are a member of IAPA which has over 130 offices located throughout the world, including major cities in Canada, the U.S., the Pacific Rim countries and Europe.

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