

GAAP for Private Enterprises



October 22, 2009

SME Conference

GAAP for Private Enterprises

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GAAP for Private Enterprises

Agenda

- 1) Decision Time for Private Companies
- 2) Development Process
- 3) Transition Issues
- 4) Changes to the Core Standards
- 5) The Financier's Perspective
- 6) Navigating the Change
- 7) Q & A

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Decision Time – Private Companies

Proposed New CICA Handbook

Standards that apply to:

- | | |
|----------|---|
| Part I | Publicly Accountable Enterprises |
| Part II | Private Enterprises, NFPOs
(unless they elect to apply IFRS) |
| Part III | Pension Plans |
| Part IV | Entities before the mandatory effective
date of the relevant parts above |

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Decision Time – Private Companies

New GAAP for Private Companies

Timing

- Standards approved by AcSB
- Issued by the end of the year
- Effective for fiscal periods beginning on or after January 1, 2011
(calendar year-end: 2011, others: fiscal 2012)
- Early adoption permitted
(starting in 2009)

➔ Option to adopt IFRS

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Decision Time – Private Companies

IFRS or New GAAP?

- For most, transition to new GAAP much easier
- Significant differences to IFRS
 - should reduce over time
- Need to consider users (current and future) of your financial statements
- What language will they want?

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Decision Time – Private Companies

IFRS or New GAAP?

- Exit Strategy
 - public in the future?
 - acquirer wants IFRS statements?
- Future Change to IFRS
 - more difficult from a 'simplified' Canadian GAAP?
 - how much time will you have to switch?
 - what resources will be available?

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Decision Time – Private Companies

IFRS or New GAAP?

- Source of Capital (debt or private equity)
 - Canadian or international?
 - competitors for capital using IFRS?
- Talent Management
 - will there be a difference in public vs. private accounting expertise?

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Development of PE GAAP

Objectives

- Meet needs of PE market
- Limit change
- Quick

Process

- Consultations with PE stakeholders
- Advisory Committee
- Secondment of PE background staff

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Development of PE GAAP

Disclosures

- Focus on needs of users in PE market
 - Most frequent user -- creditors
 - Sufficient information so users can determine whether they need more – expectation they can get more on request
- Re-examined all disclosures
- Approx 50% reduction in disclosure requirements

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Development of PE GAAP

Disclosures

- Two new disclosures included in Exposure Draft in response to user requests
 - Compensation of key management (as a group)
 - Amounts payable for government remittances – plus any amounts in arrears
- Final standards do not include management compensation or government remittances in arrears
 - Amounts payable for government remittances at year end still required



Development of PE GAAP

Disclosures

- Disclosure Supplement provides all disclosures in one place
- Disclosures are minimum disclosures
 - Section 1400 fair presentation requirements may lead to additional disclosures
- Not required to disclose information that is not material



Development of PE GAAP

EIC Abstracts

- Not retained in current form
 - Too rules oriented
- 30 issues addressed in current Abstracts embedded in proposed standards, primarily:
 - Financial instruments
 - Income taxes
 - Leases
 - Related parties
 - Revenues



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Transition Issues

First-time adoption, Section 1500

- General approach is retrospective
- Optional exemptions (*to retrospective application*)
- Mandatory exceptions (*to retrospective application*)
- Disclosure

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Transition Issues

First-time adoption

Optional Exemptions *(to retrospective application)*

- business combinations
- fair value
- employee future benefits
- cumulative translation differences
- financial instruments
- share-based payment transactions
- asset retirement obligations
- related party transactions

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Transition Issues

First-time adoption

Disclosure Requirements

- charges to retained earnings resulting from transition
- net income reconciliation for comparative year
- explanation of material adjustments to cash flow statement

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Changes to the Core Standards

The following slides are subject to publication of the final standards in December 2009

General

No size test

- No debt or equity in public markets
- Not acting in a public fiduciary role

Reduced note disclosures on premise that users have access to requisite information

Additional accounting policy choices provided

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Changes to the Core Standards

Differential Reporting

- Existing differential reporting options become accounting policy choices – no requirement for shareholder approval
 - Subsidiaries
 - Long-Term Investments
 - Interests in Joint Ventures
 - Goodwill and Intangible Assets
 - Share Capital
 - Income Taxes
 - Financial Instruments – Disclosure and Presentation

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Changes to the Core Standards

Financial instruments
 Employee future benefits, including IPP's
 Income taxes
 Stock-based compensation
 Consolidation
 Callable debt (EIC 122)
 Goodwill and intangible assets
 Business combinations

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Changes to the Core Standards

Financial Instruments

- Fair value for equity instruments traded in an active market and free-standing derivatives; “mark to market” adjustments to income
- Amortized cost for all other financial instruments (effective interest or straight-line methods)
- Fair value option to elect fair value measurement for any instrument – irrevocable election on initial recognition
- Option to not bifurcate compound financial liabilities
- Revised impairment model – trigger
 - Adverse change in amount or timing of cash flows from expectation at beginning of period

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Changes to the Core Standards

Financial Instruments (continued)

- Simplified hedging model but restricted application
 - Interest rate swaps and foreign currency contracts where contract terms match (i.e. no ineffectiveness)
 - Note disclosure with no need to establish or disclose FV of hedging instrument
- No need to identify, segregate and measure embedded derivatives (except convertible debt)
- Expense transaction costs for instruments carried at fair value (except fees to lender representing “prepaid interest”)
- Capitalized transaction costs for financial instruments measured at amortized cost
- Fair value adjustments through income – no concept of “other comprehensive income”

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Changes to the Core Standards

Employee future benefits

Simplified approach for defined benefit plans (includes IPP's)

Can be selective about which plans

Use actuarial valuation prepared every three years (for funding purposes) or when a significant event occurs, to measure obligation

Recognize all actuarial gains and losses and past service costs in income when they occur (no smoothing)

Still need to roll-forward liability and measure assets at the end of each year.

Significantly less disclosure in this section from previous GAAP requirements

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Changes to the Core Standards

Income taxes

As a policy choice an entity can choose to account for taxes using taxes payable method

On transition date all adjustments through retained earnings

No significant reduction in required disclosures for private entities

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Changes to the Core Standards

Stock-based compensation

Previous GAAP allowed private enterprises to use minimum value method (setting volatility to zero)

No longer allowed to use “minimum method” and must use internal calculation of volatility or the “calculated value method”

New standard will provide guidance on how to determine volatility, use of an appropriate index

Reduction in required disclosures (i.e no longer required to disclose assumptions used, forfeitures)

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Changes to the Core Standards

Consolidation

Retain option to use equity or cost method for intercorporate investments

If cost method is adopted, must fair value equity investments in entities that are traded in an active market (adjustments through income)

1582 Business Combinations, 1601 Consolidated Financial Statements, 1602 Non-controlling Interests

Callable Debt (“EIC 122”)

Status quo confirmed

Presentation options - “Mezzanine” classification

Goodwill and other intangibles

Impairment testing only when there is a “triggering event or circumstance”

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The Financier's Perspective

Making the Choice

- IFRS has increased disclosure requirements while GAAP for private companies has reduced required disclosures by half
 - What is relevant for the stakeholders' key points of interest?
- IFRS conversion will cost more up-front but investment may be worth it
 - Does the private company plan to go public? Have foreign lenders? Compete against public entities? Grow through foreign acquisitions? Have a parent company that reports/will report under IFRS?

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The Financier's Perspective

One of the bases for allowing GAAP for Private Enterprises and the continuance of differential reporting is the understanding that lenders can obtain information specific to their needs through additional, and sometimes more appropriate channels than the financial statements themselves.

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Common Debt Covenants

Financial and other covenants governing a credit agreement will vary from Borrower to Borrower – some of the more common financial covenants that you will need to consider are as follows:

- **Debt to EBITDA Ratio** defined as Total Interest Bearing Debt to Earnings before Interest, taxes, depreciation and amortization – Measurement of corporate leverage
- **Fixed Charge Coverage Ratio** defined as EBITDA less cash taxes to Total Payments of Principal and Interest related to existing debt obligations – Measurement of a Corporation's ability to service its debt
- **Current Ratio** defined as Current Assets to Current Liabilities, usually as determined in accordance to GAAP – Measurement of corporate liquidity
- **Minimum Equity** defined as Shareholder's Equity plus Subrogated Debt – Measurement of corporate capitalization



Differing covenants have either balance sheet or income statement implications



The Financier's Perspective



- “Fair-Value” orientation will flow through the income statement
- Volatility from “mark-to-market” financial instrument disclosure
- Impact of impairment provisions
- Callable Debt disclosure
- “Fair-Value” effects on the balance sheet
- Effects on minimum equity

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The Financier's Perspective

General Statement:

Most Creditors in Canada are well behind the curve and have done little to prepare for the new reporting regime.

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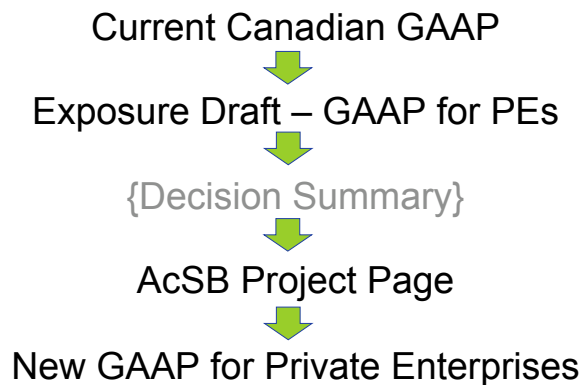
6) Navigating the Change

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Navigating the Change

Getting from point A to point B



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Navigating the Change

New GAAP for Private Companies

- Exposure Draft Content
 - summary of significant changes
 - excluded topics
 - EIC Abstracts
 - extracts from new or significantly amended standards
 - First-time Adoption (Section 1500)
 - listing of disclosure requirements

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Navigating the Change

Resources:

- AcSB Decision Summary Sept 22-23
- CA Magazine Webinar, June 19th
- AcSB Exposure Draft - *GAAP for Private Enterprises*
- AcSB GAAP for Private Enterprises FAQs
- AcSB Presentation

Links available at:

www.feicanada.org/index/private_company_committee_pcc
 (www.feicanada.org, follow the links under "Committees")

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Presenters

Gordon Heard, CA
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Gordon Heard is the Principal Advisor of The Finance Group, and is currently helping a number of companies with their transitions to IFRS and the new GAAP for private companies.

Gordon also works with the CICA, providing input on IFRS and other accounting standard education & communication from the perspective of members in industry.

The Finance Group publishes IFRS in Canada, a newsletter providing practical updates on accounting standards for public and private companies. (www.IFRSinCanada.com)

Gordon co-chairs FEI Canada's Private Company Committee and is a member of FEI Canada's Committee on Corporate Reporting.

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The
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Presenters

Mark Walsh, FCA
Principal, Accounting Standards Board
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Mark Walsh, FCA has been a Principal with the Accounting Standards Board (AcSB) since 2001 and was appointed Chair of the Emerging Issues Committee in April 2004. Prior to joining the AcSB, Mark held senior financial positions with Imperial Oil Limited in Toronto and Calgary.

Mark is a long-time FEI member and past president of Toronto Chapter and of the Committee on Corporate Reporting and a past member of the FEIC Board. He is currently a Trustee and the Treasurer of the Canadian Financial Executives Research Foundation. He was also a member of the Accounting Standards Board from 1998-2001 and of the Emerging Issues Committee from 1988-98.

Mark has been involved in a number of AcSB projects including business combinations, pensions, inventories and joint ventures. He has been heavily involved in the development of accounting standards for private enterprises.

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Presenters

Sunil Mistry, CA
Audit Partner, KPMG Enterprise

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Sunil is a KPMG Enterprise Audit Partner, where he has had extensive experience in serving private, owner-managed and private equity investee clients under the current Canadian GAAP model.

As their trusted business advisor, Sunil has worked with clients to ensure that all aspects of KPMG's services are leveraged to each of their specific needs, including managing corporate and personal tax, valuation and other advisory services. His clients include manufacturers in the automotive and forestry industries, technology companies in the software and wireless space and entertainment companies.

Sunil also has experience working on public company audits and has clients that employ US GAAP and IFRS accounting standards.



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Presenters

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Managing Director – BMO Business Finance – Bank of Montreal

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Mark has specialized in the corporate finance field for the past 20 years and is presently employed by BMO Bank of Montreal.

As past Managing Director for Bank of Montreal Capital Corporation, he oversaw a team of professionals who provided private equity and mezzanine financing solutions to businesses with revenues of between \$25 Million to \$200 Million and served as a member of the Board of Directors for over a dozen of these investee companies.

In his present capacity, Mr. Shoniker is Managing Director and Group Head of BMO Business Finance, overseeing a boutique team of financing professionals providing the full range of capital solutions to Canadian mid-market businesses. Mark also heads the Commercial Banking group for First Canadian Place. Mark is a regular speaker on behalf of BMO Bank of Montreal on the topic of innovative financing solutions for business.



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