Accounting Standards for Canada’s Private Enterprises

October 2009

KPMG ENTERPRISE™
Private Enterprises

- Adopt IFRS
- OR
- Adopt GAAP for Private Enterprises
AcSB’s GAAP for PEs

Generally Accepted Accounting Principles for Private Enterprises

April 2009
IASB’s IFRS for SMEs – Not Canadian GAAP

International Accounting Standards Board®
Press Release

9 July 2009

IASB publishes IFRS for SMEs

The International Accounting Standards Board (IASB) issued today an International Financial Reporting Standard (IFRS) designed for use by small and medium-sized entities (SMEs), which are estimated to represent more than 95 per cent of all companies.¹ The standard is a result of a five-year development process with extensive consultation of SMEs worldwide.

The IFRS for SMEs is a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller businesses. Many of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced. To further reduce the reporting burden for SMEs revisions to the IFRS will be limited to once every three years.
IFRS – A “Taste”
IFRS vs. Canadian GAAP

- Fewer bright lines and rules in IFRS
- IFRS provides more accounting policy choices
- Less interpretative guidance under IFRS
- Current text is over 2700 pages
Some Key Differences: Disclosure

- Significantly more disclosures required - why?
  - Fewer bright lines and rules requires more explanation
  - More accounting policy choices require more policy disclosures
  - Less interpretative guidance requires more professional judgement
Some Key Differences: Other

- Provision standards rely less on the concept of legal obligation
  - Provisions are recorded when “more likely than not” to be incurred instead of “likely”
  - Asset retirement obligations measured on best estimate and do not require legal obligation
  - Provisions are discounted if effect is material
  - Contingencies are recorded using a lesser threshold, like provisions

- There are no special measurement or recognition standards for related party transactions
GAAP for Private Enterprises
(subject to publication of standard in December, 2009)
AcSB’s Made in Canada Solution

- Based on existing Canadian GAAP
- Cost/Benefit assessment of contentious areas
- Reduced volume of disclosures
- Available to all Private Enterprises (no size test)
- Support from an Advisory Committee
  - Lenders
  - Preparers
  - Practitioners
Satisfaction with current Canadian GAAP
Existing differential reporting options become accounting policy choices – no requirement for shareholder approval

Additional accounting policy choices provided

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
All materials related to reporting issuers have been deleted (e.g. EPS)

AcGs and EICs have been eliminated or incorporated into the relevant standards where necessary

Standard is comprehensive – no need (or ability) to look to IFRS or US GAAP unless comply with GAAP hierarchy

Contentious areas addressed in context of cost/benefit

Plan for re-evaluation after five years
Contentious Areas

- Consolidation
- Financial instruments
- Defined benefit pension plans (IPPs)
- Income taxes
- Callable debt (ECI 122)
- Stock-based compensation
- Disclosures
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)
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
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 (excepting convertible debt)
Expense transaction costs for instruments carried at fair value (except fees to lender representing “prepaid interest”)

Capitalize transaction costs for financial instruments measured at amortized cost.

Fair value adjustments through income – no concept of “other comprehensive income”
Defined Benefit Pension Plans

- Accounting option based on funding valuation – must be applied to all defined benefit plans
- All gains/losses to current income (no smoothing)
Income Taxes

- Retain reporting options (taxes payable and allocation models)
- Revised disclosure requirements for taxes payable
Research and Development Costs

- Option to expense development costs
  - Must be consistently applied/cannot select on a project-by-project basis
Other AcSB Decisions

- **Leases**
  - No change

- **Goodwill and other intangibles**
  - Impairment testing only when there is a triggering “event or circumstance”

- **Stock-based compensation**
  - Elimination of the minimum value method
  - Must use either an entity-specific measure of volatility or an appropriate index
Callable Debt (“EIC 122”)

- Status quo confirmed
- Presentation options
- “Mezzanine” classification
### LIABILITIES

#### Current:

- Accounts payable and accrued liabilities: $530 \quad $613
- Scheduled cash repayments for long-term debt (Note X): 410 \quad 410

#### Current liabilities before callable debt (Note X):

- Current liabilities before callable debt (Note X): 940 \quad 1,023
- Callable debt (Note X): 440 \quad 330

#### Total current liabilities:

- Total current liabilities: 1,380 \quad 1,353

#### Non-current:

- Long-term debt (Note X): 425 \quad 125

#### Total liabilities:

- Total liabilities: $1,695 \quad $1,478
Business Combinations

- 1582 Business Combinations, 1601 Consolidated Financial Statements, 1602 Non-controlling Interests, expected to be part of new PB GAAP

- Effective on Adoption
Evaluating Your Options
The Options

- IFRS is an option
- GAAP for PEs
  - Early adopt for 2009 or 2010
  - Mandatory adoption in 2011
- Not-for-profits – PB GAAP model may underpin NPO accounting outside of government
Considerations

- Consistency / Comparability
  - Peers/Competitors
  - IFRS/IFRS for SMEs
- Bank covenants, employee compensation programs, etc.
- Users of your financial statements and their needs
- Strategic long-term goals of the company (e.g. IPO or sale to a strategic international company); may be costly to go back and restate
- Internal resources available and skills/competency of those resources; training required
- Impact on any systems or processes currently being used
Transitioning to GAAP for PEs

- Establish transition date

- Select among options
  - Consolidation / equity accounting / cost model
  - Fair value or amortized cost for financial instruments
  - Bifurcation of compound financial liabilities
  - Taxes payable or tax allocation model
  - Expense or capitalize qualifying development costs
  - Accounting model for defined benefit pension plans
Transitioning to GAAP for PEs - Other Issues

- Stock-based compensation
  - Appropriate indices
- Hedging programs – do they qualify?
- Volatility – impairment losses on financial assets can be reversed
- New business combination accounting model
Multiple GAAPs in the market

- Canadian GAAP with or without differential reporting
- XFI GAAP with or without differential reporting
- Canadian GAAP for PBs
- IFRS
- IFRS for Private Entities

*Communicate with your Stakeholders!*
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