

Canadian GAAP at a crossroads

Which path should private
companies choose: ASPE or IFRS?



The time to choose has officially arrived

January 1, 2011 was an important milestone for all entities reporting under Canadian GAAP. That was the date the single set of accounting standards that had historically been applied by all profit-oriented private sector entities required to comply with Canadian GAAP were essentially “retired”. But the Canadian accounting standards used to prepare fiscal 2010 financial statements are now just a fond memory from the days when there was only one part – a single set of accounting standards – to the CICA Handbook.

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Culminating a multi-year strategy, the Canadian Accounting Standards Board (AcSB), issued four new CICA Handbook “parts”, each one representing a separate and distinct accounting framework designed for the specific needs of separate groups of financial statement users. The “retired” Canadian GAAP standards will live for a short time as “Part V” of the CICA Handbook – now known as previous Canadian GAAP – but aren’t applicable beyond December 31, 2010 for most Canadian calendar year-end companies.

So, what are the new parts to the revised CICA Handbook?

- **Part I: International Financial Reporting Standards (IFRS)** has incorporated without amendment IFRSs issued by the International Accounting Standards Board. This set of standards must be applied by any entity that meets the definition of a publicly

accountable enterprise (PAE). PAEs, with a few specific exemptions, must begin reporting under IFRS for fiscal years commencing on or after January 1, 2011 – although a small number of Canadian PAEs did elect to early adopt in either 2009 or 2010. In addition, Canadian private companies can choose to adopt IFRS if they believe it’s more relevant for their operations and/or their stakeholders’ needs.

- **Part II: Accounting Standards for Private Enterprises (ASPE)** represents a specific accounting framework created for Canadian private companies, issued in December 2009 to replace Canadian GAAP. Designed to address the unique presentation, measurement and disclosure requirements of Canadian private company stakeholders, ASPEs are applicable to any profit-oriented enterprise that isn’t a publicly accountable enterprise. The AcSB developed ASPE using the original CICA Handbook as a starting point, but addressed certain common pain points for private companies. Canadian private companies that don’t voluntarily choose to adopt IFRS, must start applying ASPE for their financial years commencing on or after January 1, 2011.
- **Part III and IV** of the new CICA Handbook apply to not-for-profit organizations and pension plans, respectively.

Similar enterprise-wide impacts, different standards

While ASPE were finalized in time to permit their use for December 31, 2009 annual financial statements, the absolute deadline for adoption, is 2011 – coinciding with the debut of IFRS in Canada.

For publicly accountable enterprises and enterprises required to use IFRS by a regulator or stakeholder, IFRS is the only financial reporting option. But profit-oriented private companies can choose between ASPE and IFRS. Regardless of choice, the resulting accounting change may have several enterprise-wide impacts, potentially changing critical financial information that affects budgets, key financial metrics, contractual relationships, compensation arrangements, controls, and processes – for a start. In addition, private companies will also need to educate stakeholders about the impact on everything from day-to-day activities management to investor interests.

Making an informed decision about the right path forward

The first step in making an informed decision is analyzing the business, accounting and stakeholder considerations, and the impacts of choosing ASPE versus IFRS. Key decision-influencing considerations should include the following questions:

- What are the business and strategic considerations now and in the future?
- How do the two sets of reporting standards differ?
- What are the advantages/disadvantages of each reporting option?
- When should a decision be made?
- Will adopting one set of standards now preclude adopting the other reporting option in the future?
- What's involved in preparing for and managing an effective conversion?
- Will additional choices be introduced in the future?

Are you ready to choose?

Private companies are required to choose whether they will adopt ASPE or IFRS for their first annual financial reporting period commencing on or after January 1, 2011

ASPE or IFRS: Two options, one choice

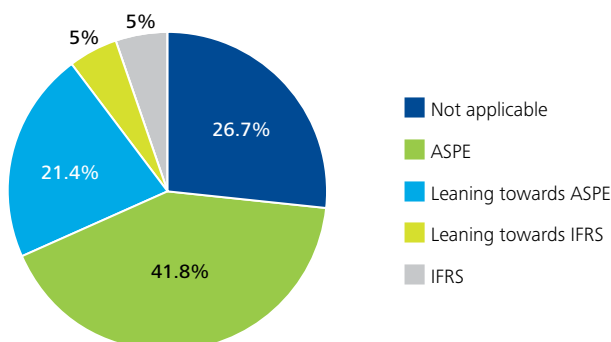
While ASPE replaces current Canadian GAAP in 2011, it isn't the only game in town for private companies. Instead of ASPE, private companies can elect to apply International Financial Reporting Standards (IFRS), being universally adopted by publicly accountable enterprises (PAEs) in 2011.

While the principles of ASPE are consistent with IFRS, there are some significant differences that any entity debating the two sets of standards should analyze. Both sets of standards enable credible financial reporting – allowing capital providers and other stakeholders to monitor the

performance of the enterprise – so the choice ultimately comes down to weighing the differences between ASPE and IFRS against the information needs of stakeholders and intermediaries. The answer will not be the same for everyone.

Survey says...

In a November 2010 webcast, Deloitte asked 400 private company decision-makers which accounting framework they were most likely to adopt.



Four key business considerations: Usability, cost, agility and specific considerations

Before getting down to the details by comparing a selection of individual standards, it's important to consider the big picture. We have identified four key factors in the ASPE-versus-IFRS debate.

1 Usability

IFRS has extensive disclosure requirements, generally resulting in significantly more disclosure than current Canadian GAAP. The nature of private company stakeholder relationships, however, often means stakeholders either don't require this level of information, or can obtain it directly. In developing the new standards, the AcSB recognized this and accordingly reduced the extent of disclosures required under ASPE, compared to current Canadian GAAP. Private companies should consider whether IFRS' disclosures will be relevant for stakeholders' key points of interest, or if IFRS is necessary for the private company to achieve its reporting objectives.

2 Cost

There's no question that IFRS conversion will cost more up-front – largely due to the scope of work involved in ingraining significant disclosure requirements within systems, processes and people; but for some companies, it's an expense well worth the investment. If there's any chance the private company might want or need to move to IFRS later (for example, if there are plans to go public; if lenders are likely to require IFRS-compliant financial information; or if the company competes against PAEs) it might make sense to pursue a direct path to IFRS. Similarly, if the company plans to grow through foreign acquisitions and other opportunities, or is working toward an exit strategy, it may ultimately be easier if all parties involved are reporting under the same standards – in most cases, IFRS. The bottom line is that private companies need to weigh short-term and long-term needs, and recognize cost as just one factor in the decision.

3 Agility

Private companies should also consider the ongoing efforts required to comply with IFRS versus ASPE. Due to its expanded disclosure requirements and complexity, IFRS is expected to have a greater impact on the organization's financial systems, internal controls and human resources. As a result, private company stakeholder interests should be considered from an efficiency perspective, both internal and external. Companies should consider how quickly they need financial information or audited financial statements to meet stakeholders' needs, and if the company's systems, processes and resources are equipped to produce IFRS-compliant financial statements on a timely basis without undue cost.

4 Specific considerations

Some of the specific attributes of IFRS or ASPE might be so appealing to a particular private company in crafting its message that it singlehandedly makes the case for adoption. A good example is investment properties: IFRS allows measuring these at fair value at each balance sheet date; ASPE does not. On the other hand, ASPE allows the taxes payable method to be used for accounting for income taxes; IFRS does not. The pros and cons of specific reporting alternatives and requirements of each reporting framework need to be considered in arriving at a choice between the two frameworks. More of these specific considerations are assessed on the following pages.

IFRS has extensive disclosure requirements, generally resulting in significantly more disclosure than current Canadian GAAP

Digging deeper: Where the standards differ

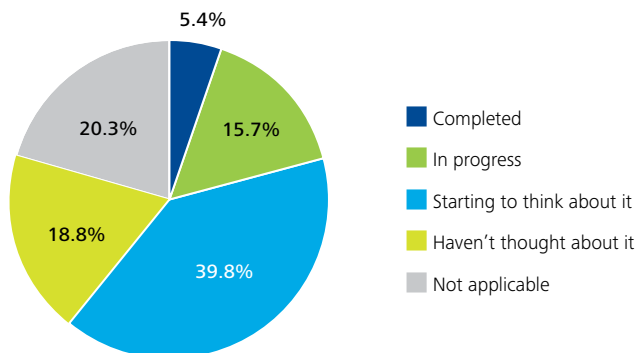
For some companies, overarching considerations such as usability, cost and agility won't be enough to sway their decision. The devil in the details – the differences between specific standards – may tip the scale to one reporting framework.

Many elements of the ASPE standards are aligned with their IFRS counterparts; others, however, are distinctly different – reflecting the AcSB's conclusion that "one size does not necessarily fit all" for financial reporting. In the tables on pages 8 and 9, we have selected

some specific topics to illustrate how the two reporting frameworks compare. While companies should perform their own analysis of the many differences, these examples are intended to get companies thinking.

Survey says...

In a November 2010 webcast, Deloitte asked 400 private company decision-makers where they were in the decision making process with respect to choosing an accounting framework? (ASPE or IFRS):



The devil in the details – the differences between specific standards – may tip the scale to one reporting framework.



How do new standards compare between ASPE and IFRS?

When weighing options, companies should consider how differences between individual standards would affect their financial reporting, the processes and systems they use to produce financial information, and the key information needs of the users of the financial statements.

Comparison: Opening balance sheet adoption provisions

Previous Canadian GAAP (Part V) No equivalent standard	
ASPE	IFRS
<p>Section 1500 of the new standards – First Time Adoption – requires that the new framework be applied consistently to all comparative information in the year of adoption, with a cumulative catch-up adjustment for all changes in accounting policy recorded in the opening balance sheet. So if a private company adopts ASPE for the year ending December 31, 2011, it will have to apply all new policies consistently from January 1, 2010 – assuming only one year of comparative information is provided. Certain transitional guidance provides assistance in applying the new standards, providing some simplifying assumptions for establishing opening balance sheet amounts for certain standards. Some of these exemptions have been modeled after those in IFRS 1.</p>	<p>IFRS also requires consistent application of the new accounting policies in all comparative periods, and has opening balance sheet requirements similar to ASPE. IFRS 1 First Time Adoption of IFRS provides 15 optional exemptions and four exceptions to the general requirement to apply all IFRS policies retrospectively, with a cumulative adjusting entry in the opening balance sheet. Conceptually, IFRS 1 is similar to Section 1500; however, IFRS 1 has more extensive disclosure and reconciliation requirements and some differences in the transitional guidance.</p>

Comparison: Financial instruments

Previous Canadian GAAP (Part V) Private companies were exempted from full compliance with financial instruments standards under previous Canadian GAAP. Therefore, companies could choose not to apply the fair value accounting measurements and disclosure required under the financial instruments standards.	
ASPE	IFRS
<p>While financial instruments accounting under ASPE is simpler than previous full Canadian GAAP requirements, there are fewer options. Some private companies will be required to measure certain investments – publicly-traded equities and free-standing derivatives, in particular – at fair value for the first time; all other financial instruments will be measured at cost or amortized cost. There is however, a fair value option that permits a private enterprise to elect fair value measurement for any financial instrument. This election must be made on initial recognition of the instrument and is irrevocable.</p>	<p>While financial instruments accounting under IFRS is substantially converged with previous Canadian GAAP, there are some differences. For example, in applying hedge accounting, IFRS does not allow for the use of the critical terms match method for assessing hedge effectiveness. Also, the lack of a notional amount in a financial instrument or contract does not result in an exemption from derivative accounting under IFRS. For private companies, there are no financial instruments accounting exceptions under IFRS. However, the financial instruments standards are undergoing a substantial change; final standards are expected to be applicable in 2013, and are expected to have fewer classification choices and provide for less complexity in hedging and impairment testing.</p>

Comparison: **Investments in associates, joint ventures or subsidiaries**

Previous Canadian GAAP (Part V)

Under previous Canadian GAAP, different reporting options were allowed for various types of investments. For example: investments in subsidiaries could be accounted for using consolidation, or the cost or equity method; investments in joint ventures could be accounted for using the proportionate consolidation method, the equity method or the cost method; investments subject to significant influence could be accounted for using the equity method or the cost method; and the presentation of investments subject to control using the cost or equity method didn't require additional disclosure, and there were no restrictions on accounting policy choice.

ASPE

Unchanged from previous Canadian GAAP.

IFRS

If conditions for preparation of non-consolidated financial statements are met, the investment in shares of the subsidiaries is either accounted for at cost or at fair value. Joint ventures may be accounted for under the equity method or the proportionate consolidation method; however, it is expected that the option to use the proportionate consolidation method will be eliminated for certain joint ventures based on the current exposure draft. Investments subject to significant influence must use the equity method, except in certain very narrow circumstances. There are no differential options for private companies.

Comparison: **Goodwill and other intangible assets not subject to amortization – impairment testing**

Previous Canadian GAAP (Part V)

Two-step impairment testing was required at least annually for goodwill and intangible assets not subject to amortization; however, a differential reporting option existed to test goodwill and such intangible assets for impairment only when an event or circumstance occurred indicating a reporting unit's fair value may be less than its carrying amount.

ASPE

All goodwill and those intangible assets not subject to amortization would be assigned to one or more reporting units when acquired, and would then be tested for impairment when there are impairment-indicating events or changes. When a reporting unit's carrying amount exceeded its fair value, the excess would be recognized in net income as an impairment loss.

IFRS

Goodwill is assigned to one or more cash-generating units for impairment testing and must be tested at least annually, or more frequently if there are indicators of impairment. Intangibles not subject to amortization or those not yet available for use are also subject to annual impairment testing. At each reporting period, companies must assess whether there are any indications of impairment.

Impairment testing is a one-step test, with no initial undiscounted cash flow screen, and more specific requirements than proposed ASPE. Write-downs are required to record the asset at the higher of fair value, less costs to sell and value in use.

Final considerations

With the above decision factors discussed, there are two final considerations: immediate timelines and future reporting requirements.

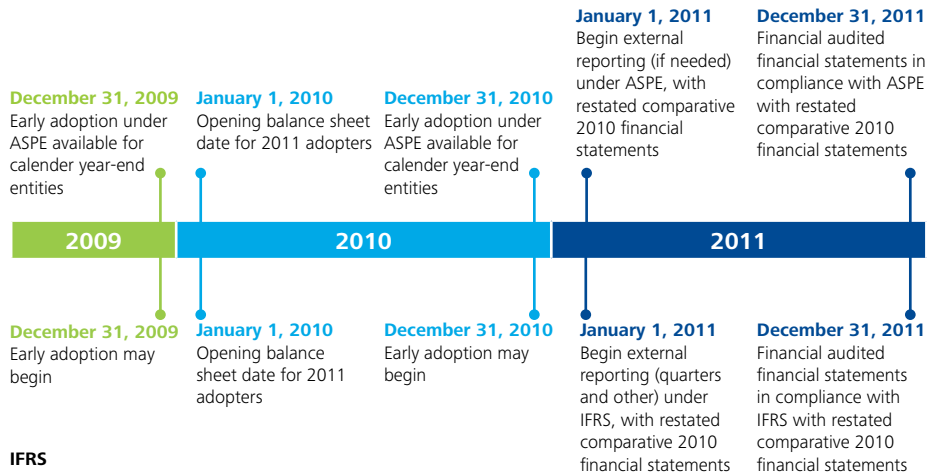
What is the timeline for making an accounting framework decision?

This varies, based on the company's financial year end and ultimate framework choice, but time is definitely of the essence. If a private company operating on a calendar year is leaning toward adopting IFRS, final framework choices must be made as soon as possible. A company that has

a September year-end has more time. With either framework, there are also critical and time-sensitive accounting elections (such as using fair value as deemed cost for property, plant and equipment) required upon first-time adoption, which should be understood and discussed with stakeholders and advisors.

Here is a comparison of the timelines for ASPE and IFRS for a calendar year-end:

ASPE



IFRS

If we choose ASPE now, can we switch to IFRS later?

A private company can choose to move to IFRS later on, if the reporting framework decision assessment initially tilts in the direction of ASPE. However, now is the time to question whether it's worth investing in conversion to one set of standards in the short-term if you foresee converting to the other in the long-run. That being said, some private companies – such as subsidiaries of public companies – may find they need to prepare financial information on two different bases: applying ASPE standards in

stand-alone statements for lenders or others, and preparing IFRS-compliant information for consolidation purposes. It's also worth noting that ASPE will evolve over time, based on concepts shared with IFRS. The AcSB intends to update ASPE as a group every one or two years, a change from the existing practice of issuing each new standard as it's completed.

If the company plans to grow through foreign acquisitions and other opportunities, or is working toward an exit strategy, it will ultimately be easier if all parties involved are reporting under the same standards – in most cases, IFRS.

What will you choose?

Now that you have an overview of a few of the differences between proposed ASPE and IFRS, it's time to decide which option works best for your business. With Deloitte's deep understanding of private company needs and complex accounting standards, our professional advisors can help you make the choice **that's right for you.**

We can help

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