

Canadian GAAP at a crossroads

Which path should
private companies choose:
GAAP for Private Enterprises
or International Financial
Reporting Standards?



Status quo is **NOT** an option

With publicly accountable enterprises working toward a 2011 deadline to adopt International Financial Reporting Standards (IFRS), Canada's Accounting Standards Board (AcSB) has forged ahead to develop a distinct financial reporting option for private companies, which make up the vast majority of all Canadian businesses. The AcSB developed these standards using the existing CICA Handbook as a starting point, but addressed certain common pain points for private companies (defined as any profit-oriented enterprise that isn't a publicly accountable enterprise). The result: in April 2009, the AcSB issued the "Generally Accepted Accounting Principles for Private Enterprises" (GAAP for Private Enterprises) Exposure Draft and invited comments from interested stakeholders until July 31, 2009.

Similar enterprise-wide impacts, different standards

Currently being finalized to incorporate recommendations from stakeholders, this new GAAP for Private Enterprises is expected to be finalized in time to permit their use for December 31, 2009 annual financial statements. The absolute deadline for adoption, however, is 2011 – in time to replace current Canadian GAAP, and aligning with the debut of IFRS in Canada.

While IFRS is the only option for publicly accountable enterprises, and for enterprises where a regulator or a stakeholder requires IFRS, profit-oriented private companies can choose between GAAP for Private Enterprises or 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 analysing the business, accounting and stakeholder considerations, and the impact of choosing GAAP for Private Enterprises 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?
- 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?

While IFRS is the only option for publicly accountable enterprises... profit-oriented private companies can generally choose between GAAP for Private Enterprises or IFRS

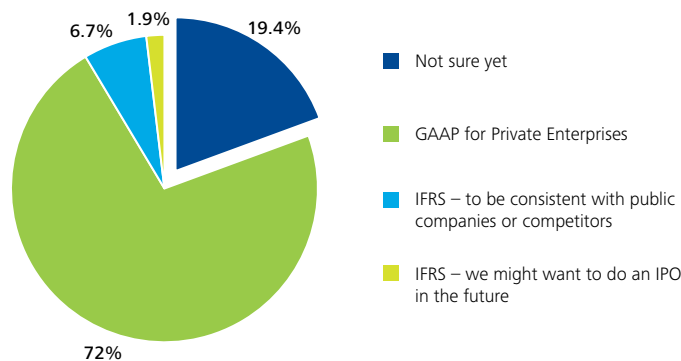
GAAP for Private Enterprises or IFRS: Two options, one choice

In April 2009, Canada's Accounting Standards Board (AcSB) released a much-anticipated GAAP for Private Enterprises Exposure Draft. While GAAP for Private Enterprises will replace current Canadian GAAP in 2011, it isn't the only game in town for private companies; there's also International Financial Reporting Standards (IFRS), which will be universally adopted by publicly accountable enterprises (PAEs) and some private companies beginning in 2011.

While final GAAP for Private Enterprises won't be available until early 2010, the exposure draft suggests that while GAAP for Private Enterprises will be largely consistent with current Canadian GAAP, there will also be significant differences – beyond the somewhat shorter length of the document. While both sets of standards enable credible financial reporting, allowing capital providers and other stakeholders to monitor the performance of the enterprise, the choice ultimately comes down to weighing the differences between the two sets of standards against the information needs of stakeholders and intermediaries. The answer will not be the same for everyone.

Survey says...

In a pair of spring 2009 webcasts, Deloitte asked 400 private company decision-makers which financial reporting system they were most likely to adopt. Nearly one in five remained undecided.



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 foresee four key factors in the GAAP for Private Enterprises-versus-IFRS debate.

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 significantly reduced disclosures required under GAAP for Private Enterprises, 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. For those seeking a "light" version of IFRS – for example, the much-talked-about IFRS for small-to-medium enterprises, recently issued by the International Accounting Standards Board – the AcSB has indicated that this option will not be incorporated into Canadian GAAP in the short term.

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 foreign 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 will 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.

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

Agility

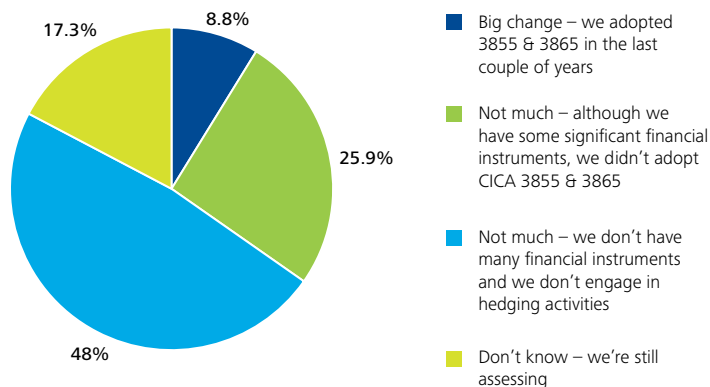
Private companies should also consider the ongoing efforts required to comply with IFRS versus GAAP for Private Enterprises. Due to its expanded disclosure requirements and complexity, IFRS is expected to have a greater impact on the organization's financial systems, internal controls and human resources. 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.

Specific considerations

Some of the specific attributes of IFRS 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; the proposed GAAP for Private Enterprises does not. Although private companies can find other ways to convey this picture – for example, as unaudited supplementary disclosure – if this information dwarfs all others in importance for stakeholders, it might override all other considerations. More of these specific considerations are assessed on the following pages.

Survey says...

In a pair of spring 2009 webcasts, Deloitte asked 400 private company decision-makers how much of a change GAAP for Private Enterprises would be for their company, related to financial instruments.



Digging deeper: Where the standards differ

For some companies, over-arching 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.

Judging from the AcSB's exposure draft, many elements of the proposed GAAP for Private Enterprises standards would align with their IFRS counterparts; others, however, will likely be distinctly different – reflecting the AcSB's conclusion that "one size does not necessarily fit all" for financial reporting. While companies should perform their own analysis of the many differences, here are a few examples to get companies thinking.

When weighing options, companies should consider how differences between individual standards would affect their financial reporting – bearing in mind, of course, that the following assessment is based on the AcSB's GAAP for Private Enterprises Exposure Draft, which is still subject to change following the comment letter process.



How do the new standards compare between GAAP for Private Enterprises and IFRS?

Comparison: **Opening balance sheet transitional provisions**

Current Canadian GAAP: No equivalent standard	
GAAP for Private Enterprises	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 GAAP for Private Enterprises for the year ended December 31, 2011, they 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 the same opening balance sheet requirements. 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**

Current Canadian GAAP: Private companies are exempted from full compliance with the financial instruments standards under Canadian GAAP. Therefore, companies can choose not to apply the fair value accounting measurements and disclosure required under the financial instruments standards.	
GAAP for Private Enterprises	IFRS
<p>While financial instruments accounting is expected to be much simpler than current “full” Canadian GAAP, there would be fewer options. Some private companies would 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 would be measured at cost or amortized cost.</p>	<p>While financial instruments accounting under IFRS is substantially converged with current Canadian GAAP, there are some differences. For example, in 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 does not result in an exemption from being accounted for as a derivative 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 will be applicable in 2011, 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**

<p>Current Canadian GAAP: Different reporting options are allowed for various types of investments. For example investments in subsidiaries can be accounted for using consolidation, or based on the cost or equity method. Investments in joint ventures may be accounted for using the proportionate consolidation method, the equity method or the cost method. Investments subject to significant influence may be accounted for using the equity method or the cost method. The presentation of investments subject to control using the cost or equity method don't require additional disclosure, and there are no restrictions on accounting policy choice.</p>	
<p>GAAP for Private Enterprises</p>	<p>IFRS</p>
<p>Unchanged from current Canadian GAAP.</p>	<p>There are restrictions on the preparation of non-consolidated statements which are difficult to meet. If 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. Investments subject to significant influence must use the equity method except in certain very narrow circumstances. Differential options are not allowed.</p>

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

<p>Current Canadian GAAP: Two-step impairment testing is required at least annually for goodwill and intangible assets not subject to amortization; however, a differential reporting option exists to test goodwill and such intangible assets for impairment only when an event or circumstance occurs indicating a reporting unit's fair value may be less than its carrying amount.</p>	
<p>GAAP for Private Enterprises</p>	<p>IFRS</p>
<p>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.</p>	<p>Impairment testing is a one-step test, with no initial undiscounted cash flow screen, and more specific requirements than proposed GAAP for Private Enterprises. Write-downs are to the higher of fair value, less costs to sell and value in use. 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.</p>

Comparison: **Disclosing management compensation**

<p>Current Canadian GAAP: Private companies are not required to disclose any management compensation.</p>	
<p>GAAP for Private Enterprises</p>	<p>IFRS</p>
<p>Expected to be one of the more unpopular proposals, compensation of key management personnel would be disclosed as a group. These disclosure proposals would appear to assume that the stakeholders who require this information are not able to obtain it directly from management, which may not be a valid assumption for many private companies in Canada.</p>	<p>Key management compensation must be disclosed in the notes of the financial statements.</p>

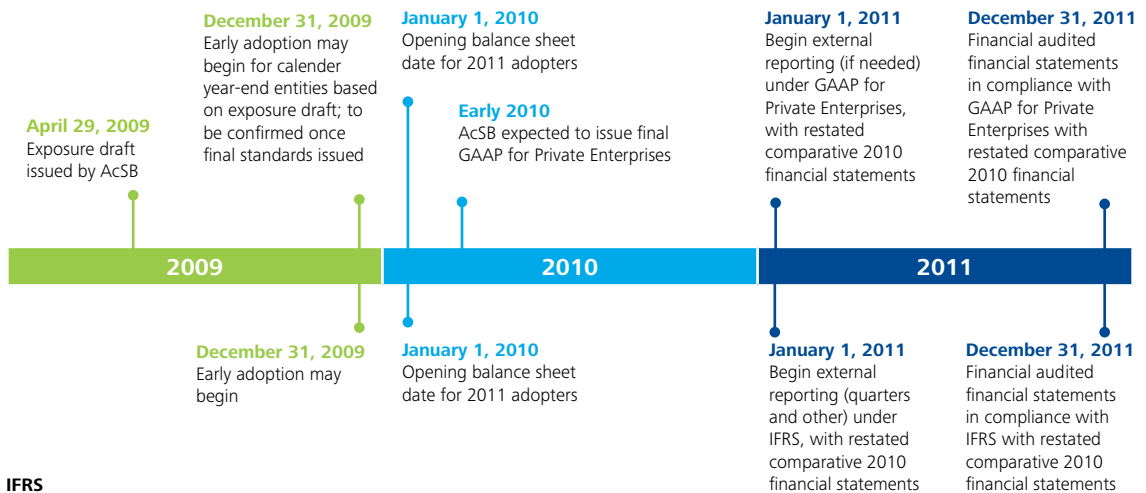
Time is of the essence

With the considerations clearly defined, three key questions remain.

1 What's the deadline for decision-making?

This varies, based on whether the company chooses GAAP for Private Enterprises or IFRS. There are also variations for first-time adopters, which should be discussed with an advisor. In general, however, here's how the timelines compare for December 31 year-end:

GAAP for Private Enterprises



IFRS

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

3 Do I – or will I in future – have any other financial reporting options?

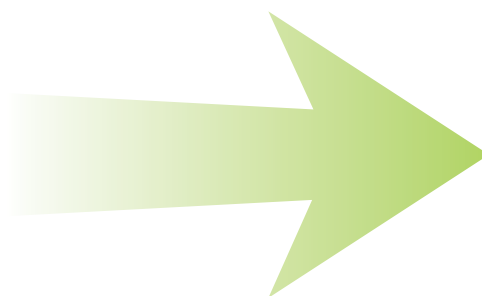
The International Accounting Standards Board (IASB) recently released simplified IFRS for small to medium-sized enterprises, leaving Canadian private companies wondering whether a third option will be thrown into the mix. The AcSB doesn't currently intend to make IFRS for SMEs an option under Canadian GAAP, but they did leave the door open for discussion, promising to revisit the issue no sooner than five years after the formal release of GAAP for Private Enterprises.

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 GAAP for Private Enterprises 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 standards, our professional advisors can help you make the choice **that's right for you.**



We can help

Our people are passionate about bringing ideas and services to private companies that reflect the best knowledge, expertise and technology available in the world, right to your door. Just ask the 30,000 Canadian private companies – and their owners – who choose to work with Deloitte. For more information, contact a Deloitte professional or visit www.deloitte.ca

National

Don Newell
416-601-6189
dnewell@deloitte.ca

Karen Higgins
416-601-6238
khiggins@deloitte.ca

Bryan Pinney
403-503-1401
bpinney@deloitte.ca

Atlantic

André Vincent
902-721-5504
avincen@deloitte.ca

Quebec

Nathalie Tessier
514-393-7871
ntessier@deloitte.ca

Marc Beaulieu
514-393-6509
mabeaulieu@deloitte.ca

Gilles Cossette
418-724-4136
gcossette@deloitte.ca

Sonia Poulin
514-393-5085
sopoulin@deloitte.ca

Louise Rainville
514-393-5239
lrainville@deloitte.ca

Richard Simard
418-624-5364
risimard@deloitte.ca

Brigitte Vachon
514-393-7151
bvachon@deloitte.ca

Ontario

Peter E. Brown
416-601-6660
petbrown@deloitte.ca

Tony Ciciretto
416-601-6347
tciciretto@deloitte.ca

John X. Hughes
416-601-6059
johnhughes@deloitte.ca

Steve Irvine
905-315-6687
sirvine@deloitte.ca

Steve Lawrenson
519-650-7729
slawrenson@deloitte.ca

Lynn Pratt
613-751-5423
lypratt@deloitte.ca

Mike Runia
613-751-6693
mrunia@deloitte.ca

Manitoba

Richard Olfert
204-944-3637
rolfert@deloitte.ca

Rick MacKay
204-944-3633
rmackay@deloitte.ca

Saskatchewan

Cathy Warner
306-565-5230
cwarner@deloitte.ca

Andrew Coutts
306-343-4466
ancoutts@deloitte.ca

Alberta

Steen Skorstengaard
403-503-1351
sskorstengaard@deloitte.ca

Paul Borrett
780-421-3655
paborrett@deloitte.ca

Sippy Chhina
403-503-1314
schhina@deloitte.ca

Leland Oberst
780-421-3644
loberst@deloitte.ca

British Columbia

Olin Anton
604-640-3006
oanton@deloitte.ca

Tim Holwill
604-640-3009
tiholwill@deloitte.ca



Proud to be the Official Supplier of Professional Services to
the Vancouver 2010 Olympic and Paralympic Winter Games



1858 **150** 2008

Deloitte celebrates
150 years of professional service



www.deloitte.ca

Deloitte, one of Canada's leading professional services firms, provides audit, tax, consulting, and financial advisory services through more than 7,700 people in 57 offices. Deloitte operates in Québec as Samson Bélair/Deloitte & Touche s.e.n.c.r.l. Deloitte is the Canadian member firm of Deloitte Touche Tohmatsu.

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms.

© Deloitte & Touche LLP and affiliated entities. TM © 2006, VANOC.
Designed and produced by National Design Studio, Canada. 09-1790