

# GAAP IFRS: Which standards to choose



**January 27, 2010**

# The journey to today

- Accounting Standards Board (AcSB) issued Strategic Plan in 2006.
- Significant changes in the standard setting environment prompted the AcSB to reconsider its standard setting strategies and policies.
- Concern that the Canadian financial reporting system could not cope with the pace of change.
- One size does not fit all.
- Approximately 5,000 public companies in Canada.
  - Represent less than 1% of the companies for which the AcSB must set accounting standards.
- Significantly more private companies in Canada than public companies.
- Not-for-profit organizations are an equally important sector in Canada.
  - Have unique financial reporting needs.
- Certain public sector organizations also were directed to CICA Handbook.
- Separate strategies are needed for each segment.

# Objectives

- Determine which type of entity your organization is:
  - Publicly Accountable Entity (PAE)
  - Government Organization
  - Private Enterprise (PE)
  - Not-For-Profit Organization (NPO)
- What GAAP options are available to your entity.
- Overview of recent developments and proposed changes to GAAP options.
- Some key differences between GAAP options.

# International Financial Reporting Standards (IFRS)

# What is IFRS?

- A comprehensive set of high quality accounting standards issued by the International Accounting Standards Board (IASB).
- Accepted or required in over 100 jurisdictions around the world.
- Consistent with Canadian GAAP in that IFRS:
  - consists of a principles-based set of standards;
  - has many choices available for application; and
  - requires significant professional judgement.
- Publicly accountable enterprises (PAEs) will be required to adopt IFRS in 2011.

## What is IFRS? (cont'd.)

- IFRS applies many of the same concepts as Canadian GAAP:
  - balance sheet approach;
  - fair value model;
  - substance over form;
  - judgment/principles vs. rules; and
  - transparency.
- Similar structure of financial statements.
- Substantially converged standards with Canadian GAAP (financial instruments, inventories, intangibles).

# PAE defined

- A publicly accountable enterprise (PAE) is an entity, other than a not-for-profit organization, or a government organization or other entity in the public sector that:
  - has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market, or
  - holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.
- When PAEs adopt IFRS, the primary standard applicable to pension plans will continue to be Section 4100, Pension Plans, instead of IAS 26, Accounting and Reporting by Retirement Benefit Plans.
- The AcSB recently issued an Exposure Draft which deals with reporting by Pension Plans, which proposes that a number of IFRS will apply to Pension Plans in 2011.

## PAE defined (cont'd.)

PAEs exclude:

- Private profit oriented enterprises that:
  - have no public debt/equity;
  - are not in process of issuing debt/equity; and
  - do not hold assets in fiduciary capacity for broad group of outsiders.
- Not-for-profit organizations (NPOs).
- Public sector entities unless directed/elect to adopt IFRS.

# Why IFRS?

- Investors seek investment opportunities all over the world.
- Cross-border mergers.
- Accounting differences can completely obscure comparisons.
- On many stock exchanges foreign listings are a large percentage of total capitalization.

# Type of changes

- Although IFRS resembles Canadian GAAP, there are areas in which small changes in wording can equal large changes in the application of standards.
- The types of changes we will see with the adoption of IFRS include:
  - the look and content of financial statements;
  - practices that are permitted under current Canadian GAAP may no longer be acceptable, and practices that were not permitted may now be the standard; and
  - forms of aggregation or measurement (e.g. provisions).

# Areas of significant change

- Property, plant and equipment
- Impairment
- Consolidations, special purpose entities and joint ventures
- Provisions and contingencies
- Income taxes
- Borrowing costs
- Industry specific: Real Estate, Rate Regulated Entities
- Presentation and disclosure
- Moving goal posts

# Application of IFRS

- Comparative statements will have to be restated under IFRS.
- IFRS must be applied to the opening balance sheet on a retrospective basis.
- IFRS 1 (First-time adoption of IFRS) and changeover disclosures.
- Adopting IFRS involves making a number of decisions which may have a significant impact on a Company's financial position and results as well as on systems, processes and related controls. A well thought out implementation plan is critical to this process.

# Benefits of IFRS

- Companies keep one set of books.
- Reduced national standard-setting costs.
- Less susceptibility to political pressures.
- Comparability with other organizations.
- Portability of knowledge and education.
- Globally accepted set of standards.

# 2010 reminders

- Impairment testing at December 31, 2009.
- Business combinations, early adopt CICA 1582 in 2010.
- Hedge accounting – complete IFRS documentation as cannot be completed retrospectively.
- Borrowing costs, qualifying assets that are commencing construction during 2010.

## Questions you should be able to answer

- What is the strategy for changeover to IFRS? (e.g., embed IFRS throughout the accounting process vs. use IFRS only at a consolidated level; use the changeover as catalyst for other change, such as streamlining processes or enhancing controls.)
- Have the leaders of business units, treasury, HR, IT, tax, and investor relations been engaged and educated on the possible implications for them of the IFRS changeover?
- What is management's rationale (pros and cons) in selecting specific accounting policies?

# Questions you should be prepared to answer

- Are the major risks and opportunities associated with the IFRS changeover being identified, evaluated, and documented?
- How is management learning about and assessing what other companies in our industry and our competitors are doing in their move to IFRS? Would industry consultation and/or consensus be desirable in any areas?

# Public Sector Accounting (PSAB)

# PSAB defined

- “PSAB” is the acronym for the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants (CICA).
- PSAB has the authority to set accounting standards for the public sector. That authority means that PSAB sets generally accepted accounting principles (GAAP) for governments.
- These standards are contained in the Public Sector Accounting Handbook (PSA Handbook).

# Why PSAB?

“Governments are inherently different than businesses. The information needed to aid understanding and assessments of government financial operations and to promote accountability extends beyond reporting surpluses and deficits. Unlike the private sector, governments are not in business to make a profit but to provide goods and services to the public, so measuring surpluses/deficits is not the key indicator of the performance of a government. Additional information that draws on information external to the financial statements adds depth to and enhances understanding of the financial statements.” (PSAB)

# Government organizations

- Includes **all** federal, provincial, territorial and municipal governments.
  - Organizations are grouped into the following types based on certain criteria, and are then accounted for using the set of accounting standards applicable to each.
    - General Government (Federal, Provincial, Municipal)
    - Government business enterprises (GBEs)
    - Government business-type organizations (GBTOs) \*
    - Government not-for-profit organizations (GNFPOs)
    - Other Government Organizations (OGO)
- \* Classification has been eliminated in the revised Introduction section to the PSA handbook; will be discussed later.

# Previous GAAP

Entity	Criteria
Federal, Provincial, & Territorial Governments	Main governments
Government business enterprise	<ul style="list-style-type: none"> <li>• Separate legal entity;</li> <li>• Delegated financial and operational authority;</li> <li>• Sells goods &amp; services outside the reporting entity; and</li> <li>• Can maintain operations &amp; meet liabilities from revenues received from outside the reporting entity</li> </ul>
Government business-type organizations	<ul style="list-style-type: none"> <li>• Separate legal entity;</li> <li>• Delegated financial and operational authority to carry on a business; and</li> <li>• Sells goods &amp; services to individuals and organizations as its principal activity</li> </ul>
Government not-for-profit organization	<ul style="list-style-type: none"> <li>• is normally without transferrable ownership interests;</li> <li>• is organized &amp; operated exclusively for a not-for-profit purpose; and</li> <li>• has counterparts outside the public sector</li> </ul>
Other government organizations	<ul style="list-style-type: none"> <li>• Is not a government; and</li> <li>• Does not meet the criteria of a GBE, or GNFPPO</li> </ul>

# Previous GAAP

Entity	Accounting used by the entity	Recording in Government FS
Federal, Provincial, & Territorial Government and its departments	PSAB	PSAB
Government business enterprise	CICA HB for profit oriented organizations	Modified equity
Government business-type organizations	CICA HB for profit oriented organizations	Consolidation- PSAB
Government not-for-profit organization	CICA HB for Not-For-Profit Organizations	Consolidation- PSAB
Other government organizations	PSAB or CICA HB for profit oriented organizations	Consolidation- PSAB

# Recent developments

## First invitation to comment (November 2007)

- PSAB announced that GBEs and GBTOs would continue to follow standards for PAEs, i.e. they would be required to follow IFRS.

## Exposure Draft (July 2009)

- PSAB issued an Exposure Draft (“ED”) concerning the future of government accounting. This ED asked readers to provide feedback on proposed changes concerning standards for government organizations.
- PSAB approved the ED in late September 2009 and issued a revised Introduction section to the PSA Handbook.

## Recent developments (cont'd.)

The changes to the Introduction section of the PSA Handbook are as follows:

- **Eliminate** the GBTO definition and re-classify each entity as either OGOs or as a GNFPO.
- **Direct** OGOs to follow either the CICA Handbook for PAEs (IFRS in 2011) or the PSA Handbook.
  - Depending on user needs and type of organization.
  - Will allow flexibility for government organizations to be more comparable with other similar public and private sector entities.
  - Criteria include but are not limited to:
    - the organization has issued publicly traded debt or equity instruments;
    - assets are held in a fiduciary capacity for a broad group of outsiders as its primary business;
    - there are commercial-type operations and revenue is substantially derived from those operations; and
    - limited government assistance is received on an on-going basis.

## Recent developments (cont'd.)

- Exposure Draft (January 2010)
  - PSAB issued an ED concerning first-time adoption of public sector accounting standards.
  - The ED provides certain exceptions and exemptions from the requirement to adopt the PSA handbook retrospectively.

# PSAB differences presentation

- Reflects service and delivery objectives of government.
- Distinguish between assets available to finance future operations and assets that will be used through the provision and delivery of services.
- Presentation differences include:
  - Financial assets and non-financial assets are presented separately.
  - Net debt (net of financial assets and liabilities) and net economic resources (accumulated surplus/deficit) presented separately.
  - Present changes in net debt.
  - Disclose capital spending and its effect on net debt.
  - Statement of financial operations details revenues and expenses for the year.
  - Includes the current year budgeted amounts for each category of revenue and expense.

# PSAB differences accounting policies

- Standards that are similar to CICA Handbook include: capital assets, revenue recognition, liabilities, contingencies, and employee future benefits.
- Standards that are similar to CICA Handbook NPO guidance: restricted assets and liabilities, government transfers (new exposure draft), related parties, and reserves.
- Potential accounting policy differences include:
  - financial instruments (see note below); and
  - landfill post closure liabilities.
- The PSA Handbook refers users to GAAP hierarchy in absence of guidance.
- In September 2009 PSAB issued an exposure draft on financial instruments which proposes to include recognition, measurement, presentation and disclosure guidance similar to what is currently followed under the CICA Handbook.

# PSAB differences IFRS

- Significant differences exist between IFRS and PSAB, such as:
  - business combinations;
  - recognition of intangible assets;
  - componentization of capital assets;
  - joint venture accounting;
  - investments in associates;
  - financial instruments; and
  - disclosures in financial statements.

# Options and timelines for financial reporting

- GBEs will be required to adopt IFRS for fiscal years commencing on or after January 1, 2011.
- The GBTO category has been eliminated. GBTOs must reclassify themselves as either GNFPOs or OGOs.
  - OGOs will be required to adopt either PSAB or IFRS for fiscal years commencing on or after January 1, 2011.
- The future of reporting for government not-for-profit organizations will be discussed in the not-for-profit section.

# GAAP for Private Enterprises

# Who can adopt Private Enterprise GAAP?

- Profit oriented entities that are not publicly accountable. Excludes:
  - Publicly accountable entities (PAE's)
  - Not-for-profit organizations (NPO's)
  - Government or government business type organizations (GBTO's)
- Private enterprises have a more limited number of stakeholders (eg., banks, shareholders, CRA).
- Private enterprises can control access to their financial information.
- Users of financial statements have ability to obtain additional information.

# Current standards

- Private companies currently follow the CICA Handbook.
- Currently have an option to apply Section 1300, Differential Reporting which allows options such as:
  - use of cost method for investments with significant influence and subsidiaries;
  - no annual requirement to test goodwill for impairment – use two step impairment testing when indicators of impairment exist;
  - taxes payable method (ie., don't worry about future taxes);
  - equity preferred shares issued in tax planning arrangements presented as equity rather than liabilities; and
  - certain relief from financial instruments requirements.
- Private companies currently have the option not to adopt many of the financial instrument sections.

# Newly issued standards

- In December 2009, the AcSB issued the standard “Generally Accepted Accounting Principles (GAAP) for Private Enterprises”.
- Major Objectives of the AcSB:
  - reduce complexity of certain standards;
  - reduce mandatory disclosure requirements – rely on general principles;
  - reduce interpretive guidance - most EICs eliminated; and
  - focus on stakeholder needs – owners, shareholders and banks
- Leveraged heavily off of the current CICA Handbook, including Differential Reporting options.
  - Some guidance from IFRS has been incorporated.
    - What about IFRS for SME’s (Small and Medium Sized Enterprises)?

# New issued standards (cont'd.)

## Timing

- Mandatorily applicable for fiscal years commencing on or after January 1, 2011 for those entities choosing GAAP for Private Enterprises (either way a change in accounting framework is required on this date).
- Early adoption will be permitted for fiscal years ending on or after December 31, 2009.

## First Time Adoption:

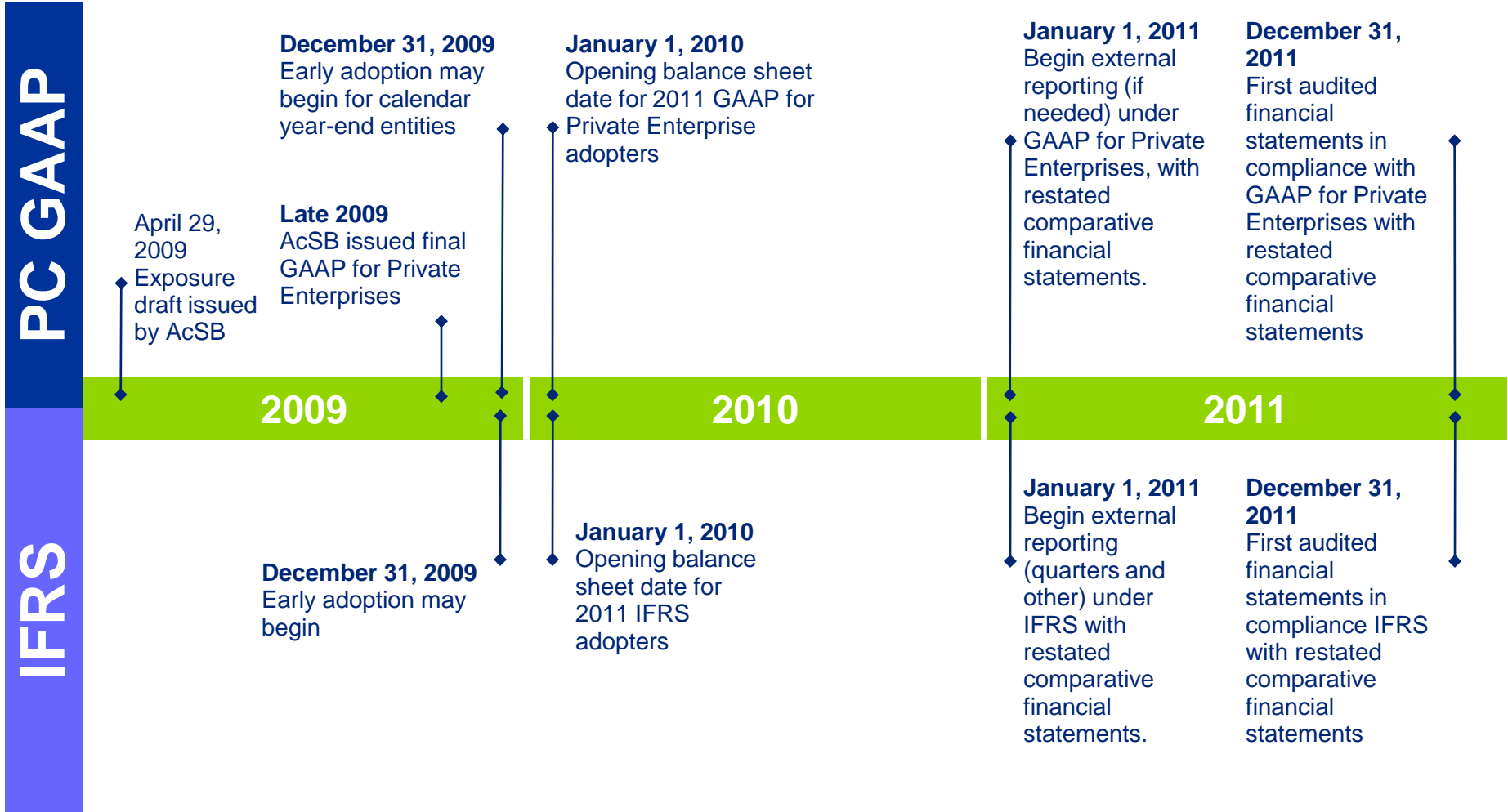
- One comparative year required.
- Special opening balance sheet transition guidance: similar to IFRS 1 guidance.
- Example:
  - December 31, 2009 year end early adoption
  - Opening balance sheet date – January 1, 2008

# Options for financial reporting

Private enterprises will have the following options for financial reporting:

- GAAP for Private Enterprises.
- International Financial Reporting Standards (IFRS).
  - All entities in Canada under the scope of the CICA Handbook have the option to adopt IFRS.
- CRA has stated that IFRS will be considered an acceptable starting point for computing taxable income and that all references to GAAP in CRA documents or tax legislation can be interpreted as IFRS for those entities that report under IFRS.

# What's the deadline for decision-making?



# GAAP for private enterprises changes

## First time adoption (Section 1500)

- New framework to be applied consistently to comparative information in year of adoption.
- Cumulative catch-up adjustment to opening retained earnings for comparative year.
- Other first time adoption guidance and relief.
- IFRS 1 is similar conceptually to Section 1500; however, IFRS 1 has more extensive disclosure and reconciliation requirements and additional transitional guidance.

# GAAP for private enterprises changes (cont'd.)

## Financial instruments

- One of the “Pain Points” for private enterprises.
- Financial assets and financial liabilities.
  - Cash, receivables, investments, debt, payables, derivatives
- New GAAP expected to be simpler than current “full” Canadian GAAP requirements.
- Will be some fair value measurement (i.e. publicly traded equity investments and free-standing derivatives).
  - Have to be quoted prices in an active market
- IFRS guidance is substantially converged with current “full” Canadian GAAP requirements with some differences.
  - IFRS standards are undergoing substantial change
  - Revised standards expected to be somewhat less complex

# GAAP for private enterprises changes (cont'd.)

Investments in associates, joint ventures and subsidiaries:

- Requirements for investments in joint ventures and subsidiaries remains unchanged from current Canadian GAAP with differential reporting options.
- Fair value option now available for investments in associates.
- IFRS has restrictions on the preparation of non-consolidated financial statements that are difficult to meet. If met, investments in subsidiaries may be accounted for at cost or fair value.
- Under IFRS, a entity can use the equity method or proportionate consolidation for a joint venture; however, it is expected that the option to use proportionate consolidation will be eliminated.
- Under IFRS, investments in associates use the equity method.

# GAAP for private enterprises changes from current standard

## Goodwill and indefinite life intangibles

- Current two-step testing under Canadian GAAP eliminated.
  - When a reporting unit's carrying amount exceeds its fair value, the excess is recognized as impairment loss
- Test when indication of impairment exists (not required annually).
- Under IFRS, impairment testing is a one step test process whereby a cash generating unit's carrying amount is compared to its fair value.
- Impairment testing is performed at least annually, and more often when indicators of impairment exist.

## Disclosing management compensation

- Compensation of key management initially to be disclosed under new GAAP.
  - This requirement was eliminated
- This disclosure is required under IFRS.

# GAAP for private enterprises changes from current standard (cont'd.)

## Other areas

- Business combinations
  - Transaction costs expensed under new GAAP & IFRS
  - Capitalized under existing Canadian GAAP
- Convertible debt
  - Current GAAP – liability/equity split
  - New GAAP – can present entirely as liability
  - IFRS – liability/equity split

# GAAP for private enterprises changes from current standard (cont'd.)

## Equity

- Preferred shares redeemable by holder
  - Current GAAP-Differential reporting allows classification as equity
  - New GAAP – equity classification
  - IFRS – generally classed as liabilities

## Derivative

- Currently hedge accounting allowed
  - Very strict eligibility requirements
- New GAAP
  - Hedge accounting even more restrictive
- IFRS
  - Very complex
  - Effectiveness criteria complicated

# GAAP for private enterprises changes from current standard (cont'd.)

## PP&E

- Canadian GAAP
  - Cost less depreciation
  - No revaluation available

## IFRS

- Depreciate component parts separately
- Component – part of PP&E that has a cost significant in relation to total cost
  - Requires more detailed accounting
- Can use cost model or revaluation model
  - Effectively “fair value” assets on a regular basis
  - Applies to the entire class of assets
  - Depreciation measured using re-valued amounts

# Say goodbye to...

## PC GAAP means saying GOODBYE to:

- ✘ Differential Reporting
- ✘ Segment Disclosures
- ✘ Interim Financial Statements
- ✘ Extraordinary Items
- ✘ Earnings per Share
- ✘ Pension Plans
- ✘ Future-Oriented Financial Information
- ✘ Insurance standards (Section 4211, AcG-3, AcG-8 and AcG-9)
- ✘ Management report, AcG-7
- ✘ Enterprises in the development stage, AcG-11

# Making the choice

- Increased disclosure requirements under IFRS; GAAP for private companies has reduced required disclosures by about 50%.
  - 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 PAE's? Grow through foreign acquisitions? Have a parent company that reports/will report under IFRS?
- Ongoing efforts to comply with IFRS.
  - IFRS is not static. More changes coming ...
- Specific considerations.
  - Fair value options for tangible property (i.e. investment properties) may be attractive to a particular private company.

# Making the choice



# Not-For-Profit Organizations (NPOs)

# NPOs defined

- NPOs are entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose.
- NPOs do not have to be charitable organizations.
- There is no controlling party and NPO members and contributors do not receive a financial return.
- Two types of NPOs:
  - NPOs in the private sector (independently operated)
  - NPOs in the public sector (controlled by government)

# Current standards

- Private Sector follows guidance in CICA Handbook unless otherwise indicated.
- Public Sector NPOs are under the authority of PSAB which directs public sector NPOs to the CICA Handbook.
- Some standards have limited or no applicability to NPOs (i.e. Differential Reporting, Business Combinations, Comprehensive Income, Segmented Reporting, Share Capital, Equity, Income Taxes, Stock-based compensation).
- NPOs must follow Section 3855, Financial Instruments – Recognition and Measurement, however may elect not to record stand-alone and embedded non-financial derivatives at fair value.
- NPOs must follow Section 3861, Financial Instruments – Disclosure and Presentation and Section 3865, Hedges but are not required to adopt expanded disclosure and presentation in Sections 3862 and 3863.

## Current standards (cont'd.)

- Sections 4400-4470 provide specific guidance for NPO accounting and financial reporting including:
  - Financial statement presentation (fund accounting).
  - Contributions - revenue recognition (deferral method, restricted fund method, endowments, contribution of materials and services).
  - Capital assets held by NPOs (addresses amortization of capital assets).
  - Reporting controlled and related entities by not-for-profit organizations.

# Recent developments

- With the move to IFRS for PAEs in 2011, the AcSB recognized an opportunity to evaluate standards for all types of entities within Canada.
- Where is the line between a PAE and an NPO? Definition of an NPO becomes very important.
- In 2009, the AcSB and PSAB recognized a need for simplicity and issued an Invitation to Comment titled “Financial Reporting for Not-For-Profit Organizations”, welcoming feedback about the potential reporting options for NPOs (closing date – June 30, 2009).

# Potential options under consideration

The following financial reporting options for NPOs under review are:

- International Financial Reporting Standards (IFRS)
  - All entities in Canada under the scope of the CICA Handbook have the option to adopt IFRS.
  - IASB may develop NPO standards; however, not likely in near future.
- GAAP for Private Enterprises Supplemented by a modified version of the 4400 Series of the CICA Handbook
  - New standards for private enterprises are currently being finalized.
  - Similar to current approach.
  - Appropriateness of private company GAAP to NPOs given different objectives?

## Potential options under consideration (cont'd.)

- Public Sector Standards Supplemented by a modified version of the 4400 Series of the CICA Handbook
  - Public sector have common objectives with NPOs.
  - Financial statement presentation distinguish between financial assets to fund future operations and non-financial assets to be consumed in the service or delivery.
  - Current PSA Handbook does not address all matters in Section 4400 series.

# Timeline for change

- The 2009 Invitation to Comment had a closing date of June 30<sup>th</sup>.
- On October 22, 2009, the AcSB approved the development of an Exposure Draft on the future direction for setting standards for the not-for-profit sector and the timing of the changeover from existing standards.
- The Exposure Draft will discuss the options previously discussed.
- The AcSB intends to work jointly with PSAB to develop Exposure Draft proposals after finalizing the strategic direction of the sector.
- Until the new direction for setting standards for not-for-profit organizations is approved, the current version of the CICA Handbook will be maintained for use by not-for-profit organizations.

# A Vision of the Future – GAAP Choices for Canadian Companies

## Not-for-Profit – Section 4400

- Exposure Draft to be issued - will discuss the options previously discussed

## Public Sector Standards

- Governments
- Other government organizations
- Not for profit organizations
- Government-not for-profit organizations (with modified 4400)

### GAAP Choices for Canadian Companies

## IFRS

- Publicly Accountable Enterprises
- Non publicly accountable enterprises
- Government Business Enterprises
- Other government organizations
- Not for profit organizations

## GAAP for Private Enterprises

- Non publicly accountable enterprises
- Not-for-profit organizations (with modified version of Section 4400)

Separate standards proposed for Pension Plans – ED recently issued

# Questions

**Deloitte.**