Canadian public companies are required to adopt IFRS in 2011. Don’t underestimate the effort required to make this transition.

The Canadian Accounting Standards Board recently confirmed the requirement for Canadian public companies to adopt International Financial Reporting Standards (IFRS) for years beginning on or after January 1, 2011. Under a current proposal from the Canadian Securities Administrators, public companies currently reporting under US GAAP in Canada would be required to adopt IFRS by 2014.

Top Accounting Issues
Although Canadian GAAP is similar to IFRS in certain respects, many differences exist. These differences can be significant and can have enterprise-wide implications.

This publication highlights some of the top accounting issues likely to arise when software companies adopt IFRS.

Revenue Recognition
Software arrangements
Similar to Canadian GAAP, IFRS does not provide specific guidance on revenue recognition for software-related transactions. When software sales arrangements provide for servicing or license arrangements in addition to the sale of software, the substance of the transaction should be considered to determine whether the various components should be treated as a single contract or accounted for separately.

The general revenue recognition criteria are then applied to each component of a software contract, as follows:

- For software products, the revenue recognition criteria for a sale of goods are applied.
- For services related to the software sold, related revenue is deferred and recognized when the services are provided, generally on a straight-line or percentage of completion basis.
- For customized software, revenue is recognized by reference to the stage of completion of development.
- For licensing arrangements, revenue is accounted for in accordance with the substance of the arrangement.

Canadian companies following US GAAP, specifically AICPA Statement of Position No. 97-2 Software Revenue Recognition (SOP 97-2) and the related Technical Practice Aids, may be able to continue to refer to this guidance through the IFRS hierarchy for the selection of accounting policies, to the extent that this guidance does not conflict with the requirements and principles of IFRS.

Multiple element arrangements
There is relatively little guidance under IFRS in respect of multiple element arrangements, other than the requirement to consider whether the components of a contract should be accounted for separately or as a single transaction. Under Canadian and US GAAP, an arrangement is separated into multiple units of accounting if:

(a) the
Discounting is also required on all provisions such as patent infringement lawsuits. The midpoint of the range is often encountered with legal claims, and a single estimate within the range is better than another, the obligation is measured at the amount required to settle the obligation. When a range of estimates exists, and no arrangement includes a general right of return on the delivered item, the delivery of the undelivered item is probable and within the control of the vendor. This approach may be acceptable under IFRS; however, the application of the specific criteria under Canadian and US GAAP may give rise to differences in practice. There also may be arrangements which qualify for separate recognition under IFRS but not under Canadian and US GAAP.

**Share-based payments**

While the general approach for the accounting for share-based payments is similar to that under Canadian GAAP, a number of differences may exist. For example, the use of the intrinsic value method is acceptable only in rare circumstances under IFRS, and for awards subject to graded vesting, each installment must be accounted for as a separate award. Companies should consider carefully existing share-based payment arrangements to determine the appropriate accounting under IFRS.

**Provisions**

Under IFRS, a provision is recognized for a legal or constructive obligation when it arises from a past event, the outflow of resources is probable, and the amount can be estimated reliably. In this context, “probable” means “more likely than not,” and represents a lower recognition threshold than “likely” as used under Canadian GAAP. More items may therefore need to be provided for under IFRS.

Under IFRS, provisions are measured based on management’s best estimate of the amount required to settle the obligation. When a range of estimates exists, and no single estimate within the range is better than another, the obligation is measured at the midpoint of the range. A range of estimates is often encountered with legal claims such as patent infringement lawsuits. Discounting is also required on all provisions where the effect of the time value of money is material. The discount rate should reflect current market assessments of the time value of money and the risks specific to the liability. Provisions must be remeasured when discount rates change.

**Impairment of Assets**

IFRS has one impairment model covering property, plant, and equipment, goodwill, and intangible assets. Assets are evaluated either individually or grouped in a cash-generating unit (CGU) for impairment-testing purposes. A CGU is the smallest group of assets that generates independent cash inflows and may be smaller than an asset group or a reporting unit under Canadian GAAP. Assets are tested, and any resulting impairment charges are measured using a one-step test that compares an asset or CGU’s carrying value to its recoverable amount. The recoverable amount is the higher of the fair value less cost to sell (a market-based model) and the value in use (an entity-specific discounted cash flow model). Since discounting is factored in when assessing impairment and impairment often is evaluated in smaller ‘asset groups’, entities are more likely to have impairments under IFRS. Further, impairment losses associated with property, plant, and equipment and intangible assets are reversed in subsequent periods if the circumstances that led to the impairment have changed.

**How Can KPMG Help?**

KPMG has helped many organizations assess the impact of IFRS and implement it. We have an established conversion methodology that incorporates the different disciplines critical to a successful implementation. KPMG’s IFRS conversion services teams are multidisciplinary teams comprised of professionals knowledgeable in IFRS and Canadian GAAP and skilled in financial reporting processes and financial integration. Our teams are actively supported by internationally trained professionals with global experience in both converting to IFRS and applying IFRS. For a full description of our conversion services, refer to our publication, Managing the Transition to IFRS: The Journey to 2011, available at www.kpmg.ca/ifrs.

To learn more about our IFRS conversion services for software companies, please contact your local KPMG office.