

International Financial Reporting Standard for Small and Medium-sized Entities

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In early July, the International Accounting Standards Board (IASB) released its long-awaited financial reporting standard for private companies: International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). The standard is the result of deliberations that began in 2003 and incorporates the findings from field testing by over 100 small companies in 20 countries, as well as input from the 162 comment letters that the IASB received in response to its February 2007 Exposure Draft.

IFRS for SMEs will not constitute Canadian Generally Accepted Accounting Principles (Canadian GAAP). Canada's accounting standards setter, the Accounting Standards Board (AcSB), released its Exposure Draft for Generally Accepted Accounting Principles for Private Enterprises (GAAP for PEs) in April 2009, and the final standard is expected to be available for use for 2009 calendar year-end financial statements; adoption is required for fiscal years commencing on or after January 1, 2011.

As IFRS for SMEs will not be Canadian GAAP, it cannot be used by Canadian companies in preparing their general purpose financial statements. However, some of the concepts within IFRS for SMEs may be considered by the AcSB for future incorporation into Canadian GAAP for PEs; therefore, it is interesting to contrast, at a high level, the two standards.

Similarities

The IASB, like the AcSB, has chosen to eliminate topics that are not relevant to private businesses, including earnings per share, segment information, and interim financial reporting. The IASB similarly achieved much of the simplification from full IFRS by reducing the policy options within the standard. Finally, the IASB believes that it too has achieved a substantial reduction in disclosure requirements.

It is particularly interesting to observe the fundamental similarities in accounting for financial instruments under IFRS for SMEs and Canadian GAAP for PEs. Similar to the AcSB, the IASB has decided that "nearly all" financial instruments should be carried at cost or amortized cost. Only equity shares that are publicly traded or for which fair value can otherwise be measured reliably are required to be measured at fair value. The IASB notes that normally it is possible to estimate the fair value of an

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asset that an entity has acquired from an outside party. Canadian GAAP for PEs will similarly focus on cost and only require equity shares to be carried at fair value when the shares are quoted in an active market.

The IASB has restricted the use of hedge accounting to a limited number of prescribed risks that include hedging specified interest rate risks, foreign exchange risks, and commodity price risks. These are very similar to the situations for which hedge accounting can be adopted under Canadian GAAP for PEs. However, even where hedge accounting is permitted, the IFRS for SMEs does not provide the significant simplifications in hedge accounting as Canadian GAAP for PEs; IFRS for SMEs retains the requirement to establish and record the fair value of the hedging instrument, whereas Canadian GAAP for PEs requires only note disclosure of the significant terms and conditions of the hedging arrangement.

IFRS for SMEs requires that all research and development costs be expensed. Canadian GAAP for PEs also requires that research costs be expensed and provides the option to expense development costs.

Differences

There are a number of notable differences between IFRS for SMEs and GAAP for PEs, some of which reflect contentious areas that were addressed by the AcSB in developing GAAP for PEs.

Perhaps of most note is that goodwill and indefinite-lived intangible assets must, in addition to being tested for impairment, be amortized. If the

estimated useful life of the asset cannot be reliably estimated, it is presumed to be 10 years, a period of time significantly shorter than the 40 year ceiling that many will remember as Canadian GAAP of the past. In Canada, we need only test for impairment; there is neither a requirement nor the ability to amortize these assets.

Another significant difference is the requirement in IFRS for SMEs to expense borrowing costs. Canadian GAAP for PEs continues to allow certain borrowing costs to be capitalized (for example, financing costs during the construction period for items of property, plant, and equipment).

The following requirements in IFRS for SMEs also differ from GAAP for PEs:

- Recognizing comprehensive income (i.e. the temporary parking lot for many types of unrealized gains and losses resulting from fair value adjustments)
- Separate accounting for major components of an item of property, plant, and equipment
- Preparing financial statements on a consolidated basis
- Bifurcating compound financial instruments, and
- Recording both current and deferred income tax provisions.

Conclusion

It is very encouraging to see the many similarities that have emerged between the approaches adopted by the IASB and AcSB in establishing an appropriate accounting framework for private companies. However, many observers believe that some of the requirements of

IFRS for SMEs, such as consolidation; componentization of property, plant, and equipment; and deferred income tax accounting do not recognize the needs of and are inappropriate for Canada's private businesses and the users of their financial statements. As such, the decision of the AcSB in 2008 to create a "made-in-Canada" solution for Canada's private businesses as our public companies transition to IFRS appears to have been well founded.

Canada's private business community will monitor the global acceptance of IFRS for SMEs with interest, as it, or some derivation thereof, is very likely our future.

Robert (Bob) Young is a Partner in the National Assurance & Professional Practice of KPMG Enterprise™. For further information regarding financial accounting standards for private companies, visit our microsite.

[Click here](#) to download the Executive Research Report entitled *Issues in Canadian Private Company Reporting* published by the Canadian Financial Executives Research Foundation and KPMG Enterprise.

For those who may not have kept abreast of the developments over the past year, refer to our resource microsite entitled **Financial Reporting Standards for Private Companies in Canada**. There you will find updates published that will provide much of the background you need to understand the issues and the choices in front of you.

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