

# Accounting Standards for Canada's Private Businesses: No Summer Vacation

Number 10

KPMG ENTERPRISE

While Canadians enjoy their summer holidays, Canada's Accounting Standards Board (AcSB) members and staff are laboring at their desks. They remain committed to the release of Canada's new Generally Accepted Accounting Principles for Private Enterprises (GAAP for PEs) in time for 2009 calendar year ends. The Board will meet in late August and again in late September to consider the responses to the Exposure Draft. Preliminary indications are that many organizations and individuals took the time to respond so the Board may have lots of input to consider.

KPMG Enterprise™ remained equally active in supporting the AcSB in bringing this important initiative to fruition. The AcSB began its consultation process in the spring of 2007 and we immediately undertook actions to hear what you, Canada's private business entrepreneur, had to say. Your responses to our 2007 online survey, **Financial Reporting Standards for Private Business**, formed the basis for our response to the AcSB's Invitation to Comment that fall. Through 2008, we continued to update the owners and leaders of Canada's private companies through a **series of communiqués**. We also co-ventured with the Canadian Financial Executives Research Foundation, commencing in January 2009, with a follow-up survey that provided the basis for an executive research forum and the CFERF Executive Research Report, **Issues in Private Company Reporting**, which was published in April 2009 and featured in the **Business Adviser**. During May and June, we engaged members of the Financial Executives Institute in seven cities and five provinces in panel discussions regarding GAAP for Private Enterprises to confirm our understanding of the sector's needs. We also met with representatives of private business in another five cities to explain the private business GAAP initiative and its potential impact on their businesses.

Based on the information we gathered, KPMG Enterprise responded to the Exposure Draft which we include for your reference. We expressed our strong support for GAAP for PEs but did offer the following comments.

We believe the AcSB has done a very good job of addressing contentious issues. However, we are concerned that the Board is not proposing simplification of the accounting for stock-based compensation. Many private companies in Canada's

## 2. Accounting Standards for Canada's Private Businesses: No Summer Vacation

research and development sector are unduly burdened by the accounting requirements for stock-based compensation. The benefits of complying with the accounting standard do not justify the costs incurred. We have recommended that a simplified cash-based model be made available to development stage companies that compensate their employees with stock awards.

We have also expressed our disagreement with the proposed disclosure requirement for compensation of key management personnel. We understand the value of the information to bankers in making their lending assessments. However, we do not believe that mandating this disclosure for general purpose financial statements is appropriate. Compensation is private and confidential and lenders can obtain this information through other, more appropriate channels.

We also observed that the AcSB has removed the requirement for management to demonstrate that a change in certain accounting policies results in equally reliable and more relevant financial reporting. While we agree that management should have free choice on transition to GAAP for PEs, we believe that thereafter the onus should be on management to demonstrate that any change is in the best interests of users. Free choice is inappropriate.

Further, we have observed that much of the information in the releases of the Emerging Issues Committee that will not form a part of GAAP for PEs remains very useful for preparers of financial statements. The AcSB should consider whether the literature could be retained

and maintained in an alternative form.

KPMG Enterprise will continue to support the AcSB in its deliberations and we will keep you informed of any significant developments.

Coincidentally, it was not only the AcSB that didn't take a summer recess; in early July, the International Accounting Standards Board (IASB) also released its new standard, *IFRS for Small and Medium-sized Entities* (IFRS for SMEs). This standard is the culmination of over five years of work by the IASB and incorporates the findings from field testing by over 100 small companies in 20 countries. While IFRS for SMEs will not be adopted in Canada in the foreseeable future, some of its concepts may be considered by the AcSB for future incorporation in Canada's GAAP for PEs and therefore it is interesting to contrast the two standards. There are a number of significant similarities, including the simplification of the accounting for financial instruments and hedges, the elimination of standards that are not relevant to private companies and the requirement to expense development costs (an option under GAAP for PEs). However, IFRS for SMEs differs from GAAP for PEs in that it mandates consolidated financial statements, accounting for income taxes using the allocation (deferral) method and recognizing other comprehensive income. IFRS for SMEs also reintroduces the concept of amortizing goodwill (and other indefinite-lived intangible assets). If the useful life of such an asset cannot be reliably estimated, it is presumed to be ten years, a period of time significantly shorter than the forty year ceiling that many will remember as

Canadian GAAP of the past. KPMG Enterprise has prepared a brief comparison of IFRS for SMEs and GAAP for PEs entitled, "**International Financial Reporting Standard for Small and Medium-sized entities.**"

As the global and Canadian economies emerge from recession, it is encouraging to see accounting standard setters responding to the unique needs of private businesses. Canada's two million private businesses will be doing their part to help our economy recover; they are clearly entitled to the efficiencies that GAAP for PEs will provide.

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.

## KPMG Enterprise Submission to the Accounting Standards Board



**KPMG LLP**  
Suite 3300 Commerce Court West  
PO Box 31 Stn Commerce Court  
Toronto ON M5L 1B2  
Canada

Telephone (416) 777-8500  
Fax (416) 777-8818  
Internet www.kpmg.ca

Mr. Peter Martin  
Director, Accounting Standards  
Accounting Standards Board  
The Canadian Institute of Chartered Accountants  
277 Wellington Street West  
Toronto, Ontario  
M5V 3H2  
ed.accounting@cica.ca

July 31, 2009

Dear Mr. Martin

### *Accounting Standards Board Exposure Draft – Generally Accepted Accounting Principles for Private Enterprises, April 2009*

Thank you for the opportunity to provide comments on the proposed Generally Accepted Accounting Principles for Private Enterprises (GAAP for PEs). KPMG applauds the Accounting Standards Board (AcSB) for undertaking the project to establish an appropriate set of generally accepted accounting principles that recognizes and responds to the needs of Canada's private businesses. Private businesses represent a significant sector of the Canadian economy with unique financial reporting requirements that are not necessarily well accommodated by either existing Canadian GAAP or International Financial Reporting Standards.

KPMG strongly supports GAAP for Private Enterprises. We have formatted our comments in response to the questions posed in the exposure draft, highlighting a number of matters that we believe the AcSB should consider in finalizing the standard.

**1. Do you agree with the proposed recognition and measurement changes? If not, please indicate, in detail, why not and what changes you would propose.**

We are in agreement with the proposed changes. However, we believe that a further change should be considered with regard to accounting for stock-based compensation for enterprises in the development stage (as established by the criteria within existing AcG 11).

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. KPMG Canada provides services to KPMG LLP.



Enterprises in the development stage often grant stock-based compensation in lieu of monetary compensation as they have limited financial resources and they wish to provide incentive to key employees to continue to “invest” in the company’s development activities. Our practitioners, clients and the lenders with whom we interact continue to tell us that there is nominal benefit to recognizing an expense for stock-based compensation for such enterprises as:

- the value of such awards cannot be reasonably estimated; it is contingent on the future commercial success of the intellectual property, technology or process being developed by the entity and as such there is significant uncertainty, both with respect to the probability of establishing commercial viability and the amount of any future value conveyed by such awards
- these awards convey no obligation by the entity to deliver cash or other assets to the recipient; rather the recipient looks to a future liquidity event such as a public offering or vending of the company to enjoy any value from the stock award, and
- the awards do not entail any cash outlay; lenders focus on cash flows and have confirmed our understanding that they “unwind” the stock-based compensation expense in their analyses of the financial statements of these companies

We would therefore recommend, for development stage enterprises only, that the AcSB provide the option of recognizing stock-based compensation on the cash basis along with appropriate note disclosure.

We also provide the following comments regarding Financial Instruments, Section 3856:

**Purpose:** Paragraph .01 should be expanded to also refer to derecognition of financial instruments, including transfers of receivables, and financial liabilities.

**Impairment:** We believe additional guidance is required regarding the impairment assessment of equity instruments carried at cost. We would recommend that the standard advise that the assessment of future cash flows be made in the context of the investor’s expectations of dividends, capital appreciation, etc.

**Liabilities and Equity:** We believe that the guidance in EIC 164, instrument B regarding accounting for the equity component when the debt is satisfied in cash should be retained.

*“If the instrument is not converted and the conversion option expires at maturity, the issuer should account for the settlement of the instrument for its redemption value (which at that point in time, would also be the stated principal amount of the instrument). Accordingly, the liability element should be derecognized, and the carrying amount of the equity element should be transferred to contributed surplus.”*

**2. Do you agree with approach to disclosures? Are the proposed disclosure requirements appropriate (i.e. are all the proposed disclosure requirements necessary and are any necessary disclosure requirements omitted)?**

With the exception of the proposed requirement to disclose compensation of key management personnel, we agree with the proposed disclosure requirements and the AcSB’s approach to reducing disclosures.



3

We do not agree with the proposed additional disclosure requirement in Section 3840, *Related Party Transactions*, with respect to compensation of key management personnel as a group. While we understand the information that the proposed disclosure is intended to provide, we believe it is inappropriate and inadequate for the following reasons:

- compensation of owner-managers and their key management employees is private, confidential information. The financial statements of private companies are often provided to suppliers and other external users who may not respect the sensitivity of such information. Many owner-managers also share their financial statements with key employees but would be reluctant to continue to do so if this information was included
- management compensation in private companies is generally a tax-driven combination of salaries, bonuses, dividends, pension contributions and other monetary and non-monetary benefits. The amounts recorded in the financial statements are not necessarily reflective of the fair value of the contributions of the owner-manager. The proposed disclosure is not sufficiently detailed to be of significant value
- the lending community can, on request, obtain this information from their customers in a meaningful level of detail
- the proposed disclosure is not contained in other fair presentation financial reporting frameworks (e.g. existing Canadian GAAP, IFRS and US GAAP)

The Board might consider requiring a “related party transaction” disclosure informing the reader that the compensation of the owner-manager recorded in the financial statements does not necessarily reflect the fair value of the services rendered to the entity.

**3. Do you agree with the approach of avoiding significant amounts of detailed guidance and interpretations (i.e., not carrying forward the EIC Abstracts)? If not please indicate, in detail, why not and how you would propose to change the approach.**

We agree with the AcSB's approach.

To the extent guidance from an EIC has been integrated into a standard (e.g. Revenue, Leases), we noted that the AcSB has not included the illustrative examples that were provided in the EICs. We believe that these illustrative examples have been of significant value to the preparers of financial statements of private business. Indeed, it is likely that many preparers will retain access to the superseded EICs and continue to use them as a reference source. Therefore, we would recommend that the AcSB or staff consider whether more comprehensive implementation guidance could be maintained in an alternative form. Otherwise, we may find preparers relying on outdated and inappropriate material.

We observed that, in paragraph 1100.24, the AcSB has referred to IFRSs as a useful/important source of GAAP to consult on matters not covered by primary sources of GAAP or to assist in applying a primary source of GAAP to specific circumstances. We believe that a reference to US GAAP should also be included as i) a number of the principles in GAAP for PEs have their roots in US GAAP and ii) to make the references consistent with the references in 1100.25 (which refers to both US GAAP and IFRSs).

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. KPMG Canada provides services to KPMG LLP.



4

**4. Certain Sections and Guidelines in the existing Handbook have not been carried forward into the proposed standards, as they are not considered relevant to private enterprises. Do you agree with excluding those Sections and Guidelines from the proposed standards?**

We agree with the AcSB's decisions.

**5. Do you agree with the proposed transitional provisions in Section 1500, *First-time Adoption*? Are there other transitional issues that have not been addressed? Are the proposals to require comparative information, prepared using the proposed standards, and to require reconciliation to the enterprise's financial statements prepared using its previous accounting policies, appropriate? Please indicate, in detail, any changes you would propose and why.**

We agree in principle with the transitional provisions proposed in HB 1500, *First Time Adoption*.

We observe that HB 1500.10 allows companies to elect not to apply HB 1582, *Business Combinations* retrospectively and sets out certain criteria for the prospective application of the standard in HB 1500.11. The verbiage is somewhat challenging - a decision tree, as an appendix to HB 1500, to interpret the paragraph would help preparers properly apply the exemption.

**6. Are there any other issues in the proposed standards for private enterprises that cause significant concern? If so, please indicate, in detail, which areas cause concern and how the standards might be modified to address these concerns.**

GAAP for PEs provides accounting policy choices which were previously only available under differential reporting and with unanimous shareholder consent. We note that these policy choices (e.g. accounting for controlled and significantly influenced entities and joint ventures) are not constrained by the criterion of paragraph 1506.14(b), namely *reliable and more relevant*. While we agree that there should be no constraint on accounting policy choices on transition to GAAP for PEs, we believe that subsequent changes should be subject to the criterion of 1506.14(b). This would help to ensure that management is not able to change accounting policies to less relevant models to avoid recognizing or disclosing matters of relevance to a user.

\* \* \* \*

We would be pleased to discuss any questions or comments you may have with respect to this letter. To do so, please contact Robert Young (416) 777-8338.

Yours truly,

KPMG LLP  
Chartered Accountants

cc Axel Thesberg, Canadian Managing Partner, Professional Standards and Risk Management  
Beth Wilson, Canadian Managing Partner, KPMG Enterprise

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. KPMG Canada provides services to KPMG LLP.