

Canadian GAAP for Private Business— The Choices to Be Made

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As Canada's Accounting Standards Board (AcSB) moves quickly to establish a new set of accounting standards for private enterprises, the Board will be confronted by a number of contentious issues. These issues, by and large, reflect complexities in existing Canadian generally accepted accounting principles (GAAP) that arose as the AcSB adopted many US standards in its then mission to reduce differences between Canadian and US accounting standards.

A number of differential reporting options were adopted by the AcSB to mitigate the impact of these standards on Canada's private enterprises. In 2002, the AcSB announced differential reporting options for private business, including

- The ability to prepare financial statements on a non-consolidated basis and to account for inter-corporate investments on the equity or cost basis
- The option to account for income taxes on a taxes-payable basis, rather than recognizing future tax assets and liabilities arising from differences in the timing of recognizing items for accounting and tax purposes,
- Accounting for preferred shares received in certain tax-planning arrangements as equity, rather than as debt.

In subsequent years, the AcSB provided additional differential reporting options relating to testing goodwill and intangible assets for impairment; even more important, perhaps, has been the relief provided from the application of certain aspects of the new financial instrument standards. However, differential reporting options can be adopted only with the unanimous consent of all shareholders and, in the view of many observers, the options have not kept pace with the needs of private business.

Recognizing the shortcomings of the existing differential reporting approach, the AcSB has tentatively identified the following areas as requiring deliberation in the development of private-business GAAP:

- Financial instruments—Should private-business GAAP be based on the fair-value model that Canada’s publicly accounting entities follow, or should it retain the historic-cost model? If the historic-cost model is retained, it is probable that private-business GAAP would not need to address comprehensive income.
- Consolidation—Should the options currently available under differential reporting, as discussed, above be retained?
- Income taxes—Is the taxes-payable method an appropriate option for private businesses? If not, is there a model, perhaps akin to deferred income taxes, that is more appropriate for private businesses than future income tax accounting?
- Classification of callable debt—Should private business be able to classify callable debt as a long-term liability based on the debtor’s intention to repay beyond the current year, rather than the creditor’s right to call the debt?
- Asset-retirement obligations—Is there a better option for private business than the fair-value model that requires estimating the future cost of reclamation, discounting the obligation to today’s value, and then accreting interest to the liability over the remaining life of the related asset? Clearly, this is a very complex model.
- Employee future benefits—Are individual pension plans (IPPs) sufficiently different than other defined-benefit plans to support a different, simplified accounting model?
- Share-based payments—While perhaps less significant to the private-business sector, the requirement to value such payments at fair value is a complexity and cost that some preparers argue is not necessary.
- Intangible assets, including goodwill and capitalized development costs— There is evidence that some lenders ascribe little value to such assets. Given the complexities in accounting for such assets, including determining the useful life and testing for impairment, is there a preferable approach?

- Related-party transactions—Existing Canadian GAAP restricts the opportunities to account for non-arm’s-length transactions at fair value. Some commentators have observed that this results in less-than-useful financial reporting when, for example, a family farm is incorporated and is required to continue to value the assets at historic cost, even when those assets are used to secure debt based on their current value.
- Disclosures—What are appropriate criteria for establishing financial statement disclosure requirements?

These are substantially the same issues that the Canadian Institute of Chartered Accountants dealt with in its financial reporting white paper *Framework for Owner Managed Enterprises* (FOME). As FOME was proposed as a non-GAAP solution, the CICA was at liberty to explore options beyond existing Canadian GAAP, including approaches being considered for small and medium-sized Enterprises by the International Accounting Standards Board. As we discussed in our previous paper, *Simplified Accounting for Canada’s Private Businesses (and Not-For-Profit Organizations?)—The Standard Setter Mounts a Full-Court Press*, the AcSB plans to parallel the existing *CICA Handbook* as closely as possible in developing private-business GAAP, and will need to develop solutions consistent with the existing accounting framework.

These matters will be addressed by the AcSB over the summer of 2008. KPMG Enterprise™ will be an active participant in the deliberations. We value your views and perspectives to help ensure we are best representing Canada’s private businesses.

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