



Private Enterprise GAAP

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Private enterprises have a choice to make as to which set of accounting principles they will follow when preparing their financial statements – International Financial Reporting Standards (“IFRS”) or Private Enterprise GAAP (“PE GAAP”). Effective with fiscal periods beginning on or after January 1, 2011, private enterprises must adopt one of these sets of GAAP – existing Canadian GAAP will no longer be an option. Early adoption is permitted.

IFRS is the set of accounting standards that have been adopted by most countries. In Canada, publicly accountable entities, such as public

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companies, will be required to use IFRS. Compared to existing Canadian GAAP, entities will have more choices with respect to the specific accounting policies that they adopt under IFRS, but will also have increased financial statement disclosures.

PE GAAP is the set of Canadian accounting standards that has been developed for private enterprises. These standards were developed using existing Canadian GAAP as the starting point and then simplified with respect to measurement and disclosure issues where possible. As a result of this, the amount of disclosure included in a set of financial statements is expected to decrease when PE GAAP is adopted, but there are differences when compared to existing Canadian GAAP.

Choosing Between PE GAAP and IFRS

Some private enterprises may wish to voluntarily adopt IFRS rather than PE GAAP. Considerations for this decision include:

- Exit Strategy – The owner of a private enterprise may wish to either go public or sell their enterprise to a public company as a way to leave the business. In such cases, it may be necessary to have IFRS compliant financial statements available;
- Sources of Financing – Some equity financiers may require financial statements prepared under IFRS;
- Comparability to Peer Group/Competitors – If an industry is comprised of primarily public companies or a private enterprise's competitors are primarily public companies, it may be useful to prepare the private enterprise's financial statements under IFRS to enhance comparability; and
- Results Reported Upon by a Public Company – If a public company holds an investment in

a private enterprise and that investment gives the public company control or significant influence over the private enterprise, then the public company may require IFRS compliant financial statements of the private enterprise so that it can prepare its own financial statements.

Assessing the Impact of Adopting PE GAAP

For many enterprises, the adoption of PE GAAP will result in a change in their financial reporting. It is important that consideration be given to the implications of these changes and to manage the changes to the extent possible. Areas to consider include, but are not limited to:

- Contracts that rely on financial information including the effect on debt covenants;
- Human resource policies such as bonuses that depend upon profitability;
- Taxation of the enterprise where Canadian GAAP is the starting point of determining taxes; and
- Changes needed to the enterprise's systems to capture any new data.

Below are highlights of some of the differences between PE GAAP and existing Canadian GAAP

Financial Instruments

Under PE GAAP, all financial instruments are measured at amortized cost except for investments in equity instruments quoted on an active market and derivative financial instruments not designated as a hedge, both of which are carried at fair value. There is also an option to carry any financial instrument at fair value that would otherwise be measured at amortized cost. This is simpler than the "newer"

financial instruments standards in existing Canadian GAAP where the categorization of the financial instrument determines whether it is carried at fair value or amortized cost.

PE GAAP requires preference shares issued pursuant to a tax planning arrangement to be classified as equity. Existing Canadian GAAP may require such shares to be classified as a liability unless a differential reporting option is elected.

The measurement of compound financial instruments may be easier under PE GAAP where it will be possible to measure the equity component at zero, thereby making the liability portion equal to the proceeds, or to use the residual method as currently permitted under existing Canadian GAAP.

Internally Generated Intangible Assets

New PE GAAP permits enterprises to choose between expensing or capitalizing internally generated intangible assets. Existing Canadian GAAP requires capitalization.

Differential Reporting

Differential reporting, as it exists under existing Canadian GAAP, has been eliminated from PE GAAP. However, some of the differential reporting options available under existing Canadian GAAP have been retained under PE GAAP, including:

- Using the equity or cost method to account for investments in subsidiaries, affiliates and joint ventures;
- Using the taxes payable method to account for income taxes; and
- Testing for impairment of goodwill and indefinite-life intangible assets only when there are events or circumstances indicating

that its carrying value may exceed its fair value

The need to obtain unanimous consent of all shareholders, as is required under differential reporting, has been eliminated under PE GAAP.

Impairment Testing For Goodwill

PE GAAP has simplified the testing for impairment of goodwill in that when book value of a reporting unit exceeds its fair value, the impairment equals this difference. Under existing Canadian GAAP, it is necessary to allocate the fair value to the assets and liabilities in the reporting unit to determine the amount of impairment of goodwill, otherwise known as the two-step approach.

Stock-Based Compensation

Volatility, which is used to determine the fair value of a stock option, may be determined using the calculated value method under PE GAAP. This method uses the historical volatility of an appropriate industry sector index as a proxy of the enterprise's own capital stock. Under existing Canadian GAAP, volatility is determined by using the share prices of specific publicly traded companies that approximates the private enterprise or assumes that volatility to be zero if the minimum value approach is adopted. The previously available option of assuming zero volatility is no longer available under PE GAAP.

Asset Retirement Obligations

The measurement of asset retirement obligations is no longer discounted for the time-value of money, removing the requirement to fair value these obligations as required under existing Canadian GAAP.

First-Time Adoption

The standards require that financial statements prepared under PE GAAP reflect the financial position and results of operations as if the enterprise has always been reporting in accordance with PE GAAP (i.e., retrospectively). Accordingly, it may be necessary to change the accounting of certain previously recorded transactions. However, this is not always practical due to a lack of currently available information of transactions that have occurred in prior years. To make the transition easier, PE GAAP provides for a number of exemptions that are discussed in more detail in the attached Appendix together with the disclosures required in the period of adoption.

First-time Adoption Provisions

The standards provide for various exemptions to ease the transition to PE GAAP. Some of these exemptions are optional while others are mandatory. Below are highlights of these exemptions.

Optional Exemptions

Business combinations

New standards for business combinations become effective for fiscal periods beginning on or after January 1, 2011. Under these exemptions, enterprises will be able to elect to apply these new business combination standards to all combinations that have occurred after a date of their choosing, as long as that date is no later than the transition date. The transition date is the first day of the earliest period for which an entity presents full comparative information under PE GAAP. For example, if an entity adopts PE GAAP for its December 31, 2011 year end and presents comparative information for the year ended December 31, 2010, then the transition date is January 1, 2010. If the enterprise elects January 1, 2010 as the date that these new business combination standards apply, then any business combination that occurred prior to January 1, 2010 would remain relatively unchanged and any after that date would be required to follow the new standards.

Fair Value

In the period of adopting PE GAAP, enterprises will be permitted to change the cost basis of an item included in property, plant and equipment to its fair value as at the transition date. This provision is not available in any other period. Enterprises may want to consider adopting this exemption where an item in property, plant and equipment has a fair value

that is significantly higher than its current carrying value. However, caution should be exercised when electing this exemption because i) if applied to a depreciable item, amortization of that item will be higher in future periods thereby reducing net income in those future periods and ii) the risk of future impairment of the asset will be higher. Accordingly, enterprises may want to restrict this exemption to non-depreciable property, plant and equipment such as land. Also, it is important that enterprises obtain appropriate evidence to support the fair value being attributed to the item.

Employee Future Benefits

Enterprises will be able to elect to record any cumulative actuarial gains and losses and past service costs not previously expensed directly to retained earnings as at the transition date.

Cumulative Translation Differences

Cumulative translation accounts arise from the consolidation of self-sustaining subsidiaries and are reported as a separate item in equity. Enterprises will be able to elect to set the cumulative translation account to zero as at the transition date.

Financial Instruments

For any financial asset or financial liability, an enterprise may elect to carry it at fair value as at the transition date. Normally, under PE GAAP, such a designation can only be made in the period in which it is first recognized. Also, enterprises may elect to record any adjustment to financial assets and financial liabilities arising from the adoption of PE GAAP to be charged to opening retained earnings.

Stock-Based Compensation and Other Stock-Based Payments

Enterprises may elect not to re-calculate any stock-based compensation and other stock-based payments where it was issued prior to the transition date and the minimum value approach was used to determine fair value.

Asset Retirement Obligations

Any adjustments made to the carrying amount of asset retirement obligations arising from the adoption of PE GAAP may be charged to opening retained earnings as at the transition date.

Related Party Transactions

Enterprises may elect not to adjust the measurement of any related party transactions that occurred prior to the date of transition.

Mandatory Exemptions

Derecognition of Financial Assets and Financial Liabilities

Enterprises are not permitted to recognize any non-derivative financial assets or non-derivative financial liabilities as at the transition date if those assets or liabilities have been derecognized in a prior period.

Hedge Accounting

As at the transition date, any deferred gains and losses that have been previously recorded as an adjustment to the carrying value of the hedged financial asset or liability will be reported in its component parts; i.e., the financial asset or liability will be adjusted to its amount as if the hedge did not exist and the derivative will be recorded as a separate asset or liability.

Estimates

Enterprises may not update estimates that exist as at the transition date for new information. Such estimates should be consistent with the estimates made at that time after allowing for any adjustments that may arise from differences in accounting policies.

Non-Controlling Interests

Enterprises with non-controlling interests on their balance sheet must account for the following transactions on a prospective basis from the transition date or upon adoption of the new business combination standards, whichever is earlier:

- Accounting for changes in the parent's ownership interest in a subsidiary that does not result in a loss of control;
- Accounting for a loss of control over a subsidiary; and
- Attributing income or losses between the owners of the parent and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance.

Disclosures in the Period of Adoption

In the period of adoption, there are certain disclosures that will be required, including:

- An opening balance sheet of the enterprise prepared under PE GAAP as at the beginning of the earliest comparative period presented in the financial statements. For example, if an enterprise adopts PE GAAP for their December 31, 2011 year end, and they also present comparative figures for the year ended December 31, 2010, an opening balance sheet as at January 1, 2010 must also be presented;

- An explanation of the changes to opening retained earnings of the adjustments recorded as a result of adopting PE GAAP;
- A reconciliation of net income for comparative periods as previously reported under another basis that was not PE GAAP to the net income for those comparative periods as determined under PE GAAP. For example, if an enterprise adopts PE GAAP for their December 31, 2011 year end, and they present comparative figures for the year ended December 31, 2010, assuming that there was a previously published set of financial statements for the year ended December 31, 2010, a reconciliation of the previously reported fiscal 2010 net income to the 2010 net income determined under PE GAAP will be required;
- An explanation of any material adjustments made to the statement of cash flows for the comparative period providing that a statement of cash flows had been previously published that was prepared on another basis that was not PE GAAP; and
- The optional exemptions used in preparing the financial statements.

Readers are reminded that these are only the highlights of the exemptions provided in PE GAAP and that they should consult with their Collins Barrow advisor and the CICA Handbook before acting upon these exemptions.