



Conversion to Accounting Standards for Private Enterprises:

Basic Transition Steps



Overview

For fiscal years beginning on or after January 1, 2011¹, private enterprises will have to adopt either the new Canadian accounting standards for private enterprises (ASPE) or International Financial Reporting Standards (IFRSs). These standards are respectively in Part I and in Part II of the *CICA Handbook – Accounting*. This brochure suggests some basic transition steps to facilitate the transition of private enterprises to ASPE.

ASPE were developed specifically to meet the needs of private enterprises and the users of their financial statements. They recognize that the primary users of the financial statements are lenders rather than equity investors. They also recognize that many private enterprises have only a limited ability to apply complex accounting standards.

Private enterprises need to take the time and effort required to understand the new standards, including available options and alternatives, and to make the required changes to processes and other systems. These accounting changes must be applied retrospectively, which means that the comparative figures (balance sheet and income statement) for the fiscal year ends may need to be restated to comply with the new standards.

¹ When the end of an enterprise's annual reporting period does not coincide with the end of a calendar year, the mandatory date for first-time adoption is the beginning of the annual period that commences on or after December 21, 2010.

Transition Steps for Private Enterprises

The implications of the transition to ASPE will vary according to the accounting standards the entity used prior to the changeover. The implications will also depend on the entity's transactions.

The following basic transition steps are recommended:

1. Consider the Options

Management needs to first determine whether ASPE or IFRSs best meet the entity's needs.

A decision to move to IFRSs would depend on much more than the accounting requirements of the standards. Consider the entity's long-term strategic plans and the users' needs and expectations. The following circumstances could make IFRSs the more attractive choice:

- ➔ Impending initial public offering and/or plans to sell the entity into a global market.
- ➔ Potential debt or equity financing from foreign sources that do business using IFRSs.
- ➔ Parent company and/or large number of subsidiaries use IFRSs.
- ➔ Main competitors are public enterprises; therefore, using IFRSs will facilitate comparisons.
- ➔ Lenders and other users want the entity to report on the same basis as a public company for comparative reasons.

The costs and benefits of adopting IFRSs or ASPE also need to be assessed. In order to do that, management needs to understand the changes in ASPE, relative to the accounting standards that have been in use, and determine the impact of the transition on the entity's financial reporting and operations.

2. Select On-going ASPE Accounting Policies

Private enterprises adopting ASPE need to understand the specific changes and accounting policy choices contained in the new standards. Management needs to determine which accounting policy best meets the needs of the users of the enterprise's financial statements; this may involve discussion with the key users.

Other considerations include the relative work effort and cost of the different options, as well as the impact on the income statement, balance sheet, financial ratios, and other financial statement-based metrics.

Significant accounting changes

ASPE provide a greater number of accounting policy choices as compared to the old standards. Many, but not all, of the new choices are based on existing differential reporting options that were provided in the pre-changeover standards. However, these options are not subject to the requirement for unanimous shareholders' consent.

In addition, ASPE mandate new recognition and measurement provisions for financial instruments, business combinations, goodwill impairment, stock-based compensation, and asset retirement obligations. Some of these changes simplify the amount of information and analysis required to prepare financial statements, such as the revised one-step impairment test for goodwill. Others, such as business combinations may require more information and analysis than the old standards.

3. Determine Transition Timeline

Private enterprises adopting ASPE must apply the framework for annual fiscal years beginning on or after January 1, 2011 (see footnote 1).

ASPE must be applied on a retrospective basis; accordingly comparative periods will be presented using the new standards. Section 1500 of accounting standards for private enterprises provides transition guidance for the first-time adoption of ASPE. Under this standard the "transition date" is the beginning of the earliest period for which an entity presents full comparative information under ASPE.

Examples of key transition dates for selected dates of adoption are summarized below:

Fiscal Year of Adoption	Comparative Period	Transition Date / Opening Balance Sheet Date
December 31, 2011	December 31, 2010	January 1, 2010
April 30, 2012	April 30, 2011	May 1, 2010

Why consider the changes now?

Accounting policies need to be selected for the preparation of the opening balance sheet and applied from the transition date.

By considering these changes now, an entity will ensure that it has all the information required for the ASPE financial statements. Being proactive may also impact choices in the comparative year, which might decrease the amount of reconciliation required in the transition year.

4. Apply Section 1500, *First-time Adoption - Transition Rules*

Section 1500 provides transition guidance for the first-time adoption of ASPE. It is designed to address first-time adoption by all enterprises, regardless of the accounting framework that has been applied historically. Section 1500 provides some elective relief from the requirement to apply ASPE retrospectively and certain mandatory exceptions from retrospective application.

Management needs to consider the one-time elective exemptions and the mandatory exceptions in determining the opening balance sheet at the transition date. In addition, management must consider the special presentation and disclosure requirements for the first set of financial statements under ASPE.

5. Prepare the Opening Balance Sheet

The entity needs to ensure that its first set of financial statements prepared under the new standards is transparent for users and comparable over all periods that are presented. The general approach is retrospective application. Therefore, at the opening balance sheet date, all assets, liabilities, and components of equity should be reviewed and:

- ➔ Recognized if they meet recognition criteria under ASPE;
- ➔ De-recognized if they do not meet recognition criteria under ASPE;
- ➔ Appropriately classified according to ASPE; and
- ➔ Measured using accounting policies effective under ASPE.

The comparative financial statements have to be restated in accordance with the new standards, and presented as if the entity has always applied these standards. Any differences from the previous GAAP measurements will be taken as an adjustment to opening retained earnings at the transition date.

6. Prepare ASPE Disclosures

The entity should re-examine disclosure requirements. Overall, the new standards require fewer disclosures however, this will vary from company to company depending on the type of transactions and the complexity of the business. Consider drafting the notes to the financial statements from scratch rather than adapting existing notes to new requirements. This will help ensure that the entity is not just adding to the notes, but is benefiting from any reductions in disclosure.

The objective is to provide sufficient information so as to give fair presentation of an enterprise's financial position, operating results, and cash flows, and to help users gauge when to ask for more information on specific issues or transactions.

Another new feature of ASPE is the provision of a compilation of disclosures that brings them together in one place; located in Part II of the *CICA Handbook - Accounting* immediately before the "Highlight" summaries.

7. Other Considerations

Transitioning to ASPE is not just an accounting exercise. The impact of the new standards on the following considerations may influence some policy decisions; therefore, they require careful consideration and or advanced communication:

- ➔ **Contracts** - Debt covenants with lenders or suppliers should be reviewed for potential impacts of ASPE adoption.
- ➔ **Human Resources** - Employee bonuses and other incentive programs need to be revisited; also, consider additional resources that might help with the transition.
- ➔ **Tax** - Consider the effect that applying ASPE will have on accounting income when reconciling to taxable income, or the effect it will have on other areas, like claiming the Small Business Deduction.
- ➔ **Supporting Documentation** - Consider all additional data sources that will be needed, such as appraisals or valuations.

In the event that your decision is to have a calendar year adoption in 2011, the key items to work on *immediately* are:

- ➔ Selection of the accounting policies where options are provided.
- ➔ Preparation of 2010 comparative balance sheet and income statement under ASPE.
- ➔ Preparation of the opening balance for 2010 under ASPE.
- ➔ Preparation of related note disclosure under ASPE.
- ➔ Assessment of changes and impact of the ASPE transition on both internal and external contracts.

Visit the CICA's designated Accounting Standards for Private Enterprises website for a range of resources and learning opportunities:

www.cica.ca/PRIVATEENTERPRISES





Summary of Exemptions and Exceptions in Section 1500, *First-time Adoption*

One-time Exemptions from Retrospective Application

- **Business Combinations, Stock-Based Compensation, and Related Party Transactions** – These are exempt from full retrospective application of ASPE for awards and transactions prior to the transition date;
- **Asset Retirement Obligations** – Private enterprises that have not previously recognized asset retirement obligations on a basis consistent with Section 3110, may measure the obligation at the date of transition in accordance with ASPE and estimate the amount that shall be included in the carrying amount of the related asset based on the original and remaining life of the asset;
- **Property Plant & Equipment (PP&E)** – A transitional provision allows an entity to measure items of PP&E at fair value, and use that fair value as the “deemed cost” going forward;
- **Employee Future Benefits** – There is an option to recognize all cumulative actuarial gains or losses into retained earnings at the date of transition;
- **Foreign Currency Translation** – There is an option available to deem the Cumulative Translation Account to be zero at the date of transition; and
- **Financial Instruments** – Private enterprises are permitted to re-designate any financial asset or liability to be measured at fair value and need not separate the components of a financial instrument that contain both a liability and equity component if the liability component is no longer outstanding at the transition date.

These decisions may have broader accounting consequences that should be considered; for example, revaluing PP&E to fair value may increase the value of the asset on the balance sheet; but it will also result in increased amortization for depreciable assets, and it may increase the likelihood of a future impairment.

Finally, management will need to consider what will be required to meet “sufficient appropriate audit evidence” for the revaluation of the PP&E in the case of an audit or review engagement.

Mandatory Exceptions from Retrospective Application:

Section 1500 prohibits retrospective application in the four following situations:

1. Derecognition of financial assets and financial liabilities
2. Hedge accounting
3. Estimates
4. Non-controlling interests

Private enterprises will most likely be impacted by the prohibition regarding estimates. It prevents companies from using the benefit of hindsight in determining estimates at the date of transition. For example, if in hindsight an entity transitioning to ASPE on December 31, 2011 found out that it did not incur bad debts to the extent that management had originally estimated in its December 31, 2009 financial statements, it would not revise its estimated allowance for doubtful accounts in its opening balance sheet as at January 1, 2010 (i.e. the transition date).

Transitional Presentation Requirements and Disclosures:

Section 1500 requires the minimum presentation and disclosures regarding the adoption of ASPE in the first set of ASPE financial statements. These requirements are as follows, with examples of dates provided for companies with a calendar year adopting in 2011:

- a) **Opening balance sheet** - It must be prepared on the first day of the comparative period for the year in which ASPE are first adopted (the "date of transition"), which would be prepared as at January 1, 2010 in our example. This opening balance sheet must be presented in the first set of financial statements prepared under ASPE. This can most easily be accomplished by adding a third column to the balance sheet.
- b) **Reconciliation of equity at the date of transition** - The first set of ASPE financial statements must disclose a reconciliation showing all the changes to opening retained earnings as a result of adopting ASPE, that is as at January 1, 2010 in our example.
- c) **Reconciliation of income** - The first set of ASPE financial statements must also disclose a reconciliation showing all of the changes to net income in the entity's most recent previously issued financial statements to its net income under ASPE for the same period. In our example a reconciliation of net income for the year ended December 31, 2010 would be disclosed.
- d) **Disclosure detail** - The disclosures in b) and c) must give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement.
- e) **Cash flow statement** - If an entity presented a cash flow statement under its previous accounting policies, it will need to explain the material adjustments to the cash flow statement.



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