

Conversion to Accounting Standards for Private Enterprises

Transition steps to help your company



Overview

Private enterprises now have accounting standards developed specifically for them: Accounting Standards for Private Enterprise (ASPE). The new standards meet the needs of private enterprises more effectively and recognize that the primary users of the financial statements are owner/managers and 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.

Transition Steps for Private Enterprises

The implications of the transition to ASPE will vary according to the accounting standards the entity is currently using. The implications will also depend on the entity's transactions.

To assist you with your transition, we recommend taking the following basic transition steps:

1. Decide which “Canadian GAAP” to Use

Management needs to first determine which accounting framework best meets their needs, ASPE or IFRS. For most private enterprises, the best option will be ASPE as it is less onerous than IFRS.

- ➔ Management will have to contemplate their long-term strategic plans for the entity and consider users' needs and expectations to ensure ASPE and not IFRS, is the logical choice.
- ➔ Management will then need to understand what the changes are in ASPE, relative to the present accounting standards in use, and determine the impact of the transition on their financial reporting and operations.

Management will then be in a position to make an informed decision as to which framework best meets the needs of the entity.

2. Consider IFRS

The decision to move to IFRS will depend on much more than just the accounting requirements of the standards. Generally it will be a strategic decision. The following are circumstances that will make adopting IFRS a more attractive choice:

- ➔ There may be an IPO in the next few years and/or plans to sell the entity into a global market.
- ➔ There is potential debt or equity financing from foreign sources that do business using IFRS.
- ➔ A parent company and/or large number of subsidiaries use IFRS.
- ➔ The entity's main competitors are public enterprises; therefore, using IFRS will facilitate comparisons.
- ➔ Lenders and other users want your company to report on the same basis as a public company for comparative reasons.

3. 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 choices best meet 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

There are an increased number of accounting policies available to entities under ASPE, compared to current GAAP. Many, but not all, of the new choices are based on existing differential reporting options, but without the current requirement for unanimous shareholders’ consent.

In addition, ASPE mandates 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 from current practice.

For an accessible resource that provides a useful summary of these changes, see “What’s Changed?” – *CA Magazine* June/July 2010. (Go to: www.camagazine.com>archive>print edition> June-July 2010)

4. Determine Transition Timeline

Private enterprises must choose the accounting framework they will use for annual fiscal years beginning on or after January 1, 2011. However, earlier adoption is permitted.

ASPE must be applied on a retrospective basis; accordingly comparative periods will be presented using ASPE. ASPE sec. 1500 provides transition guidance for the first-time adoption of ASPE. ASPE sec. 1500 introduces the concept of the “transition date”, which is used throughout the transition guidance. The transition date is the beginning of the earliest period for which an entity presents full comparative information under ASPE.

Examples of ASPE key transition timeline 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 available that will be 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. For example because of the general transition requirements to restate the comparative period, business combinations that occur in the comparative period will have to be restated.

The new CICA sec. 1582 *Business Combination*, which permits early adoption, has been carried forward to the new ASPE. Adopting sec. 1582 to business combinations in the comparative period will eliminate the need to restate the transaction again on the transition date.

5. Apply ASPE sec. 1500, First Time Adoption - Transition Rules

ASPE sec.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. ASPE Sec. 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.

6. Prepare the Opening Balance Sheet

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

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

The comparable 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.

7. Prepare ASPE Disclosures

Re-examine your disclosure requirements: Overall, the amount of reduction in disclosures 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 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 Handbook immediately before the Highlight summaries.

8. Other Considerations

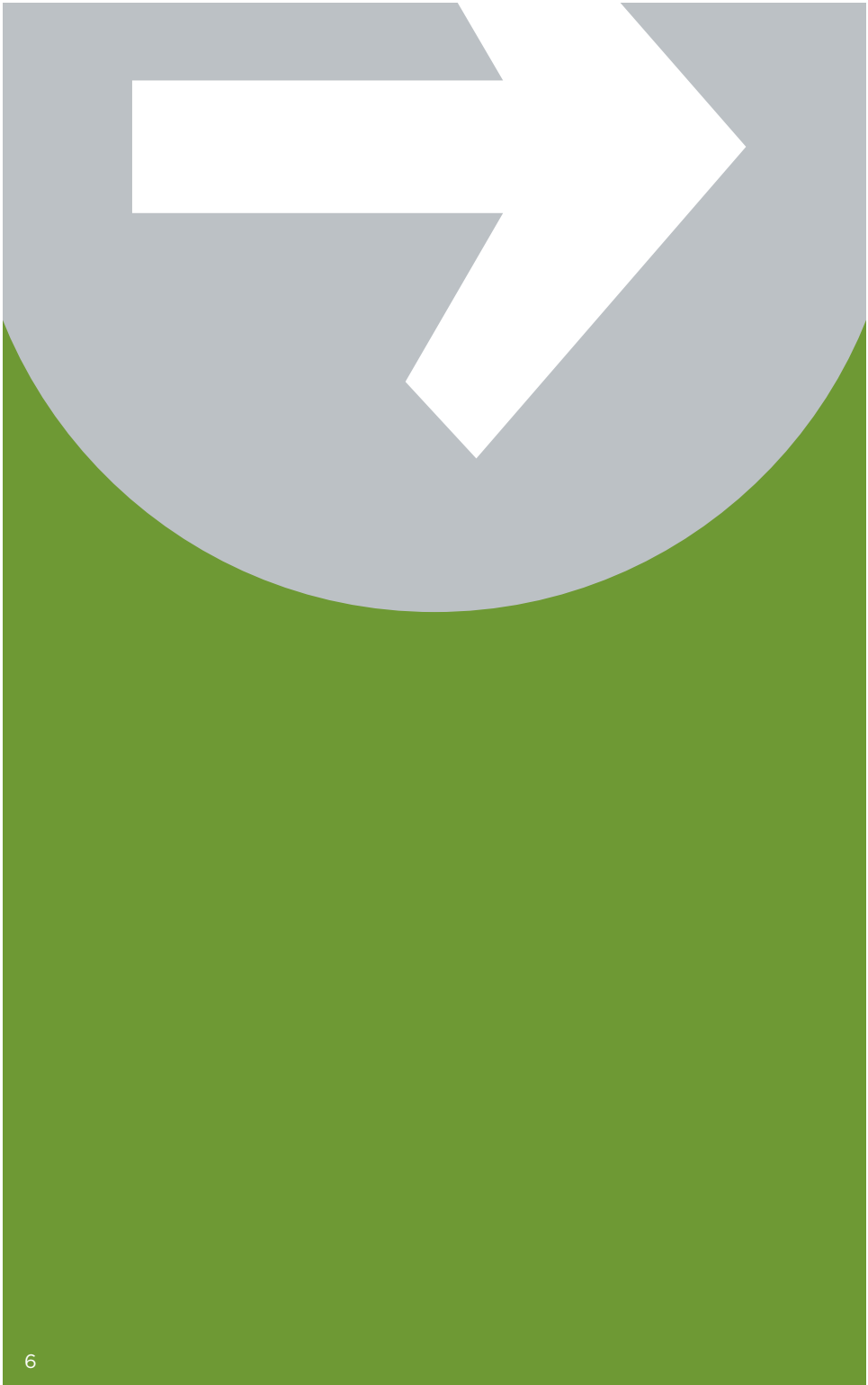
Transitioning to ASPE is not just an accounting exercise. The impact of the new standards on the following considerations may influence some of your policy decisions; therefore, they require careful consideration and/or advanced communication:

- ➔ **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 you 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:

- the 2010 comparative balance sheet and income statement applying ASPE;
- the preparation of the opening balance for 2010;
- the related note disclosure; and
- the need to adequately discuss the changes and consider the impact of the ASPE transition on both internal and external contracts.

To learn more about the new accounting standards for private enterprises, visit the CICA's Standards in Transition website - www.cica.ca/PE, refer to the CICA's Guide to Accounting Standards for Private Enterprises in Canada, or attend a course through your provincial Institute/Ordre on the transition to new accounting standards for private enterprises.



Summary of Exemptions and Exceptions in sec. 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 CICA sec. 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, any, or all, 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:

ASPE sec.1500 prohibits retrospective application in the four following situations as follows:

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. The prohibition regarding estimates prevents companies from using the benefit of hindsight in determining estimates at the date of transition.

For example, assume that a company will adopt ASPE for its calendar year ended December 31, 2011, so its transition date is January 1, 2010. The company prepared financial statements for its lenders for the year ended December 31, 2009, which included management's estimate of an allowance for doubtful accounts of \$45,000. During 2010, the company found that it did not incur bad debts to the extent originally estimated by management - bad debts were only \$20,000. ASPE sec.1500 requires the opening balance sheet as at January 1, 2010 to report the allowance for doubtful accounts to be \$45,000, the same amount as reported as at December 31, 2009. ASPE 1500 prohibits management from reducing its allowance for doubtful accounts as at January 1, 2010 and revising the original estimate, even though bad debts, in hindsight, were only \$20,000.

Transitional Presentation Requirements and Disclosures:

ASPE 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:

- a) **Opening balance sheet** – This must be prepared on the first day of the comparative period for the year in which ASPE is first adopted (the “date of transition”). 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. For companies with calendar year ends adopting ASPE in 2011, the opening balance sheet will be presented as at January 1, 2010.
- 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. For companies with calendar year ends adopting ASPE in 2011, a reconciliation of equity as at January 1, 2010 will be disclosed.
- 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 entities most recent previously issued financial statements to its net income under ASPE for the same period. For companies with calendar year ends adopting ASPE in 2011, a reconciliation of net income for the year ended December 31, 2010 will 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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