

# **Accounting Standards for Private Enterprises**

## **— Transition Considerations for a Non-Complex Entity**

**March 2011**

*Notice to Reader*

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## Introduction

The new accounting standards for private enterprises (ASPE) are effective for fiscal years beginning on or after January 1, 2011. ASPE must be adopted on a retrospective basis which will require comparative financial information for 2010 as well as an opening balance sheet as at January 1, 2010 (assuming a calendar year-end). ASPE were developed based on Part V of the *CICA Handbook – Accounting* and, as such, many of the new standards will seem familiar. ASPE can be found in Part II of the *Handbook* (HB).

This summary is intended to assist in the transition of a non-complex entity to the new accounting standards; it provides highlights of significant changes and provides items for consideration. Note that this summary is not comprehensive and may not highlight or deal with all the issues that may apply to a specific non-complex entity; it is intended only to raise awareness for typical balances on a set of financial statements and does not contain all of the requirements. Topics such as business combinations (for which there is a whole new standard that is significantly different from the previous standard), employee future benefits, foreign currency translation and more complex issues related to financial instruments such as de-recognition and hedging, to name a few, are not addressed given that they seldom apply to non-complex entities.

## Other resources available

- ▶ CICA's Accounting Standards for Private Enterprises website ([www.cica.ca/PE](http://www.cica.ca/PE)) provides a wide range of resources, including responses to frequently asked questions, webinars, articles and publications including the *CICA's Guide to Accounting Standards for Private Enterprises in Canada* which provides a summary comparison of the new requirements with the pre-changeover accounting standards.
- ▶ Professional development courses are presented by provincial CA Institutes/Order. Visit their websites directly or find appropriate links at [www.cica.ca](http://www.cica.ca).
- ▶ CICA model financial statements – Private Enterprises Part II of the *CICA Handbook – Accounting* are available for purchase through [www.CAstore.ca](http://www.CAstore.ca) or membership to [Knottia](http://Knottia) or any provincial Institute/Order.

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Cash	Sections 1510, 3856		No significant changes.	
Portfolio Investments	Sections 1510, 3856	At the date of transition, an entity is permitted to designate any financial asset or financial liability to be measured at fair value in accordance with Section 3856.	Section 3856 provides the option of accounting for any financial instrument at fair value by designating fair value measurement to apply. This may be helpful when considering investments that are thinly traded or ceased to trade for a short period of time. However, you will need to consider the assurance implications related to the determination of fair value for thinly traded equity instruments.  If investments are measured at fair value, the income tax accounting policy should be considered. If the entity elects future income taxes, there will be temporary differences between the accounting basis and tax basis.	There are a number of significant changes to be aware of:  Equity securities that are quoted in an active market must be accounted for at fair value with unrealized gains and losses going through net income.  Another significant item that may result in the recognition of an asset or liability upon adoption is the requirement to account for handling derivatives (for example, foreign exchange forward contracts) at fair value. The unrealized gains/losses are recognized through net income. Although this may appear to be a new requirement, the guidance was previously included in EIC 125 - <i>Accounting for Trading Speculator or Non-Hedging Derivative Financial Instruments</i> under the CICA HB XVI.  Transaction costs related to financial instruments that are measured at fair value must be expensed. Specific guidance related to transaction costs is included in Section 3856.  Consider the effects unrealized gains/losses may have on reporting requirements such as covenants or compensation arrangements.  Consider modification to the accounting policy note for portfolio investments and the treatment of transaction costs.
Accounts receivable, trade and other	Sections 1510, 3856			On initial recognition, amounts receivable are recognized at fair value; this initial value is the basis for subsequent measurement at cost or amortized cost, unless the fair value method is selected for subsequent measurement. When determining fair value, if an amount is receivable over time and does not bear a market rate of interest, the fair value is not equal to the cash consideration. As such, the entity will need to consider if discounting is required. The decision will likely be based on the potential materiality of the effect of discounting, which depends on the length of time and the size of the discount rate. If the expected discount is not material, there will likely be no change from current practice.
Inventory	Section 3831			Assuming full compliance with Section 3031 - <i>Interpretation</i> , which was effective for fiscal years beginning on or after January 1, 2008, there are no recognition or measurement changes. If the entity has not yet adopted Section 3031, now is the time to do so. The new standard has a few minor reductions in the disclosure requirements.

# ASPE consolidated

Prepaid expenses	Section 1510		No significant changes.
Loans and advances receivable	Section 3836		<p>Keeping in mind that the fair value of non-interest-bearing receivables or below-market-interest-rate receivables is likely not equal to the cash consideration, loans and advances receivable must be discounted upon initial recognition, unless the discount is not material.</p> <p>All financial assets are subject to an impairment test if there are indicators of potential impairment. When discounted cash flows have been the basis for a past impairment, there is likely going to be a difference under the new standard. Previously, cash flows were discounted using the original effective interest rate; however, under the new impairment test for all financial assets, cash flows are required to be discounted using the current market rates of interest. Remember that under ASPE, impairments of financial instruments are reversible.</p> <p>The presentation and disclosure requirements related to impaired loans and foreclosed assets have been reduced.</p>
Long-term investments	Sections 3835, 3051, 3055	<p>The accounting policy choices in ASPE are similar to the differential reporting options that were available under pre-changeover accounting standards except that the cost method should not be used for investor's equity securities that are quoted in an active market.</p> <p>These investments may be accounted for at fair value, with changes in fair value recorded in net income.</p>	<p>For investments in subsidiaries, entities with significant influence and joint ventures, the options for cost, equity, consolidation or proportionate consolidation have not changed from those under differential reporting.</p> <p>However, if the investment is an equity security that is traded in an active market, the cost method option is not available; such investment may be accounted for at fair value however. For example, if an entity has an investment that enables it to exercise significant influence in a company that is traded in an active market, accounting for the investment at cost would not be an option; the available accounting policy options would be the equity method or fair value.</p> <p>Consider the change in the impairment standard for long-term investments. Previously, impairment was based on a consideration of whether a decline in value was temporary or permanent. Any decline considered to be permanent were recognized and could not be reversed. Under ASPE, impairments are recognized if there is an indication of impairment and there is significant adverse change in the expected timing or amount of future cash flows from an investment. Impairments are reversed if events occurring subsequent to the impairment have reduced the initial impairment. As such, the entity should consider whether any past impairment should be reversed at the time of transition.</p> <p>Remember that ASPE-15 Consolidation of Variably Interest Entities was retained. This guideline is basically the requirement to consolidate entities that you control regardless of equity interests. The requirements are difficult, and significant effort may be required to determine if there is a variable interest entity and whether consolidation of that entity is required. The entity can preclude this analysis through the preparation of non-consolidated financial statements, if that is an option for the entity.</p>



# ASB 306.4-306.7

Property, plant and equipment (PP&E)	Sections 306.1, 306.3	May elect to measure an item(s) of PP&E at fair value at the date of transition.	<p>There is a one-time exception available to use fair value as the deemed cost at the date of transition. Remember that this choice can be made on an asset-by-asset basis and does not allow for fair value measurement on an ongoing basis.</p> <p>The effects of revaluing PP&amp;E on future depreciation, potential future impairments and covenant calculations will have to be considered.</p> <p>In evaluating this option, consider what information will be required to support the fair value of PP&amp;E (as at January 1, 2010, for a calendar year-end). Is there a need to obtain an independent valuation to provide evidence of the fair value or will other means of supporting the fair value be acceptable?</p> <p>Consider what information should be included in the accounting policy note in relation to deemed costs.</p> <p>Any significant remeasurements that result in increases in retained earnings will increase taxable capital for income tax purposes and may result in a grind on the entity's small business deduction or a reduction in the SRED expenditure limit.</p>
Deferred charges, intangibles and goodwill	Section 306.4	May choose to expense development costs; however, the accounting policy must be consistently applied to all projects.	<p>Assuming that the entity adopted Section 306.4 – Goodwill and Intangible Assets, which was effective for years beginning on or after October 1, 2008, there are a few changes to consider.</p> <p>Impairment testing for goodwill is required to be considered when there are events or circumstances that indicate there may be impairment. This is effectively the integration of a differential reporting option into the standard. Additionally, the impairment test was simplified as the goodwill impairment loss is determined as the carrying amount of the reporting unit less the fair value of the reporting unit. This eliminates the two-step approach formerly used and the need to fair value the individual assets and liabilities.</p> <p>Unlike financial instruments, impairment losses cannot be reversed.</p> <p>The related accounting policy notes will likely need to be updated.</p>

Section 306.4.74

# **LIABILITIES AND EQUITY**

Bank overdrafts	Sections 1510, 3856		The concepts included in EIRC 122 – <i>Balance Sheet Classification of Callable Debt</i> and EIRC 59 – <i>Long Term Debt with Conversion Features</i> have been carried forward. Debt with a demand feature remains a current liability.	An illustrative example of the disclosure has been provided in Section 1510.
Notes payable and bank debt	Sections 1510, 3856		As noted above, upon initial recognition the fair value of a financial instrument with non-market interest rates must be discounted unless the discount is not material.	
Accounts payable and accrued liabilities	Sections 1510, 3856		There are new disclosure requirements for amounts payable with respect to government securities. This disclosure may be on the face of the balance sheet or in the notes to the financial statements.	Section 1510 15
Income taxes	Section 3465	The options available under differential reporting have been carried forward as an accounting policy choice: taxes payable method or future income tax method.	No significant differences. Consider the impact of fair value accounting for various financial instruments or the optional bump up in PPE when selecting the tax accounting policy as those create temporary differences that would be recognized under the future income tax method. Remember, if the entity elects to use the taxes payable method, it is required to disclose a rate reconciliation of income tax expense to the statutory rate.	Section 3465, illustrative example 4 provides an example of a secure requirements under the taxes payable method.
Loans and advances payable	Section 3856		As noted above, upon initial recognition the fair value of a financial instrument with non-market interest rates is required to be discounted unless the effect of the discount is non-material.	
Leases	Section 3865		The concept of capital leases versus operating leases has been retained with some additional guidance related to impairment of lease receivables.	
Long-term debt	Section 3856		If the entity elects to measure the debt at fair value, the related transaction costs are recognized as an expense. Otherwise transaction costs and financing fees are adjustments to the fair value upon recognition. The transaction costs and financing fees are then recognized over the expected life or term of the debt.	The guidance for accounting for transaction costs and financing fees is in Section 3856.



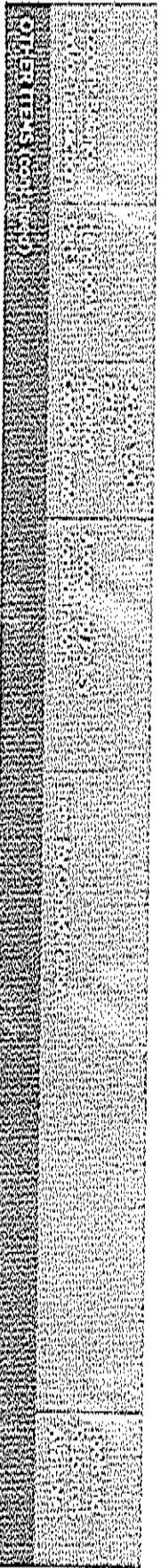
# THE LITTON SECURITIES COMPANY

Asset retirement obligations	Section 3110	An exemption is available to recognize asset retirement obligations that were not previously recognized based on the remaining life of the asset.	Under the new standard, measurement of asset retirement obligations is on a best estimate approach, which should represent what an entity would pay to settle the obligation at the balance sheet date. The capitalization of the asset retirement cost and consideration of remeasuring the liability based upon the passage of time or environmental/technological changes are still present. This is the opportunity to recognize asset retirement obligations that may have been overlooked.	
Equity	Sections 325L, 3856	There are two acceptable methods for initial measurement of the equity component of convertible debt. The equity component can be measured at zero or the residual method can be applied.	There is a new definition for contributed surplus that includes only contributions by equity holders. Preferred shares issued under tax planning arrangements are required to be presented as equity, with disclosure of the redemption amount on the face of the balance sheet. Unless repayment has been demanded, there is no longer an option to present these preferred shares as a liability. Under the new business combination and consolidation requirements in Sections 1582, 1601 and 1602, non-controlling interests is presented as a component of equity. Capital disclosures as previously required in Section 1533 are no longer required under the new standard.	
Stock-based compensation	Section 3870	An exemption is available for any compensation granted or issued prior to the date of transition. There is no measurement or remeasurement required.	This standard is applicable to private enterprises and should be considered for applicability whenever there are issuances of shares, options, warrants or other equity instruments. Succession planning has increased the number of these types of transactions in private enterprises. The minimum value method has been replaced with the calculated value method. This will require the use of volatility in the measurement of the fair value of stock-based compensation.	A number of service providers are available to provide volatility information such as StockWagon.com, and Excel spreadsheets for Black-Scholes and binomial fair value calculations are distributed widely on the Internet. Be sure to test the spreadsheet for accuracy.









Contingencies, commitments	Sections 3283, 3290, A-G H	No significant changes.	
Financial statement disclosures		<p>Although there is an overall reduction in the required disclosures, keep in mind that under Section 1400 – <i>General Standards of Financial Statements Presentation</i>, fair presentation requires sufficient, clear and understandable information to be provided to understand the transaction and the effect on the entity.</p> <p>With a change in the accounting framework, a comprehensive disclosure checklist might be used to ensure that all items have been properly considered, remembering however, that judgment must be applied to determine the information that should be disclosed and that non-material disclosures are not required.</p>	<p>See compilation of disclosure requirements included under HIB Part II.</p> <p>See Sections 1510, 1520 and 1521 (new guidance) for presentation and disclosure requirements and examples.</p>

