

GAAP for Private Enterprises

AcSB
Exposure Draft

*Background Information
and Basis for Conclusions*

FOREWORD

In May 2009, the Accounting Standards Board (AcSB) released an Exposure Draft, “[Generally Accepted Accounting Principles for Private Enterprises](#),” proposing separate standards for private enterprises. The AcSB has also approved the contents of this document setting out its rationale for the Exposure Draft proposals. The AcSB believes that the Background Information and Basis for Conclusions document will assist readers of the Exposure Draft in understanding its proposals.

June 2009

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INTRODUCTION

- 1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching the conclusions in developing the Exposure Draft, “Generally Accepted Accounting Principles for Private Enterprises.” It sets out the reasons the AcSB undertook the project to develop the Exposure Draft, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.
- 2 Nothing in this document is to be taken as overriding the proposals in the Exposure Draft. However, the discussion may help readers to understand how the AcSB reached its conclusions in developing the proposals and the AcSB’s intent with respect to their interpretation and application.

BACKGROUND

- 3 In its Strategic Plan, issued early in 2006, the AcSB noted that “one size does not necessarily fit all” and decided to pursue separate strategies for publicly accountable enterprise, private enterprises and not-for-profit organizations. These strategies reflect the different needs of users and cost-benefit considerations in each sector.
- 4 The Exposure Draft (ED) responds to requests from private enterprises for standards that focus on the needs of this sector and the users of their financial statements. Respondents to earlier consultations expressed a strong preference for standards for private enterprises in the short-term whilst expressing concerns about the education and training burden of introducing a new financial reporting system. In developing the ED proposals, the AcSB consulted extensively with the private enterprise sector. Details of the process followed are provided in the Appendix.
- 5 The ED proposals were developed using the following approach:
 - (a) the existing CICA Handbook – Accounting was used as a starting point;
 - (b) the standards are principles-based and encourage the use of professional judgment;
 - (c) issues in the existing Handbook that have caused significant concern to private enterprises were reconsidered on the basis of cost/benefit to preparers and users in the sector;
 - (d) the majority of the recognition and measurement requirements in the existing Handbook do not cause significant concern to private enterprises and have been retained with few, if any, modifications;
 - (e) Disclosure requirements were re-evaluated based on the needs of external users of financial statements of private enterprises, with the expectation that there would be considerably fewer disclosures.”

MAIN FEATURES OF THE PROPOSED STANDARDS

Available for use by all private enterprises

- 6 Private enterprises reporting under Canadian GAAP may use the standards applicable to publicly accountable enterprises (i.e., International Financial Reporting Standards (IFRSs)) or, alternatively, the proposed standards for

private enterprises. The AcSB notes that many private enterprises have indicated that they wish to report under IFRSs. The AcSB intends that any private enterprise be able to use the standards for private enterprises. There will be no size or other qualifiers for use of the proposed standards. The AcSB set out its rationale for not adopting a size test in the 2007 Invitation to Comment (ITC) and Discussion Paper. The vast majority of respondents agreed with the AcSB's tentative conclusion and rationale on this issue.

- 7 Use of the proposed standards and the alternatives within them are policy choices. Unanimous consent of shareholders is not required, unlike the requirements to use differential reporting. Some stakeholders noted that obtaining unanimous consent was sometimes a barrier for private enterprises wishing to adopt differential reporting. Others noted that consent was only required from shareholders, while the most significant external users of private enterprises' financial statements are usually lenders. The AcSB noted that the unanimous consent provisions in differential reporting were, in part, due to differential reporting being a part of standards that applied to public and private enterprises. Since the proposed standards have been developed based only on the needs of private enterprises, this factor is not a consideration in the proposed standards. The AcSB concluded that a set of standards for private enterprises developed with input from all categories of constituents and through full due process should be available to all private enterprises.
- 8 The proposed set of standards fully stand alone (i.e., it does not require reference to other standards for guidance). Many respondents to the ITC clearly did not favour a system that required significant knowledge and understanding of the standards applicable to public enterprises, which would increase preparers' education and training requirements.

Consistent conceptual frameworks

- 9 The 2007 Discussion Paper stated the arguments and tentative conclusion of the AcSB for having consistent conceptual frameworks for private and publicly accountable enterprises. The AcSB did not see that the differences between publicly accountable enterprises and private enterprises require or justify different conceptual frameworks. The AcSB decided that the application of cost/benefit considerations, as set out in the conceptual framework, would result in accounting that was largely similar for the two sectors but appropriately addressed their differences. This proposition was widely accepted by respondents to the ITC who agreed that it would be too confusing to stakeholders to have fundamental differences in the building blocks of financial reporting for different categories of reporting entities.
- 10 The ED retains the current conceptual framework in FINANCIAL STATEMENT CONCEPTS, Section 1000, which is consistent with the International Accounting Standards Board's (IASB) "Framework for the Preparation and Presentation of Financial Statements." The IASB has a joint project with the US Financial Accounting Standards Board (FASB) to develop an improved common conceptual framework. Over time, the AcSB intends that Section 1000 will be updated to remain consistent with the IASB conceptual framework.

Starting point — existing CICA Handbook – Accounting

- 11 The proposed standards have been developed from the existing Handbook, with modifications as described below.
- 12 The proposed standards represent a “Made in Canada” approach, which could have consisted of a complete “fresh start” (i.e., starting from the conceptual framework and developing an entirely new set of standards). This approach was rejected on the following grounds:
 - (a) The vast majority of respondents to the ITC, as well as participants in roundtable forums, believe that the existing set of standards, in the aggregate, is not fundamentally flawed. Change is required only in selected areas to address the needs of the private enterprise sector.
 - (b) A complete redevelopment would take a significant amount of time and, therefore, would not be responsive to the widespread view that the proposed set of standards should be available in the short term,
 - (c) A fresh start approach implies that the new standards would be significantly different from what exists today. A completely different set of standards would likely require a significant amount of education and training costs. Stakeholders were clear that the overall financial reporting system is stretched thin as a result of the AcSB’s publicly accountable enterprise strategy and, accordingly, were not receptive to having to expend significant resources for education and training related to private enterprise standards.

Free choice of simplified treatments

- 13 The proposed standards provide alternative treatments on several topics, allowing an individual enterprise choice of accounting treatments in these areas. The AcSB intends that these options be “free choices”, not subject to the requirements in ACCOUNTING CHANGES, proposed paragraph 1506.14(b), to assess the relevance and reliability of the information produced under accounting policy alternatives on other issues. The AcSB based this decision on practical considerations. It does not wish entities to be inhibited from using the simplifications provided by some of the alternative treatments because of the challenges of demonstrating relevance and reliability.
- 14 Research into the needs of users indicated that a significant number of users do not favour a “menu” approach that allows entities to choose accounting treatments on particular topics (for example, under differential reporting, to consolidate or not consolidate subsidiaries or to follow the taxes payable or future taxes method in accounting for income taxes). These users note that free choice can make it significantly more difficult to analyze and compare financial statements, and voiced support for an “all or nothing” approach, such that all private enterprises would follow substantially the same accounting policies, or at least a restricted number of policy choices. The AcSB noted this view and tried to keep the number of policy choices to a minimum. In several cases, simplifications in the proposed standards have been made the required method of accounting rather than providing alternative treatments (for example, with goodwill impairment testing and classification of preferred shares issued pursuant to certain tax-planning arrangements). However, in other areas, the AcSB concluded that the simplified method should continue to be optional, so as to allow private enterprises to be more comparable with public enterprises and also allow individual enterprises to conduct their own

cost/benefit assessments in selecting accounting policies. During the course of discussions, several users on an Advisory Committee consisting of preparers, auditors and users involved with private enterprises created to aid in the development of these standards noted that, under the proposed standards, users may need to take a pro-active approach in indicating which policies they wish certain enterprises to use, more so than has been the case under differential reporting.

Future changes

- 15 The set of standards proposed in the ED will not be static. Change will be necessary to ensure that the standards remain of a high quality and address evolving reporting needs in the private enterprise sector. The AcSB has agreed that the proposed standards should be changed on a less frequent basis than has been the case with the existing Handbook. In comparison to publicly accountable enterprises, private enterprises generally have fewer resources to devote to education and training and other costs related to keeping up to date with standards. The standards will be updated on an annual or biennial basis, with each update potentially consisting of changes to several standards. The AcSB believes that this bundling of changes will be sensitive to the needs of this sector.
- 16 In general, the AcSB intends to make no changes to the proposed standards for some time following their finalization, so that stakeholders in the private enterprise sector have time to absorb and become familiar with the new system. However, the proposed standards carry forward ACCOUNTING GUIDELINES AcG-12, Transfers of Receivables, (as Appendix B of FINANCIAL INSTRUMENTS, Section 3856) and AcG-15, Consolidation of Variable Interest Entities. These Guidelines are based on parts of US GAAP that are currently recognized as needing improvement and international projects are underway to address these topics. The AcSB will consider whether to change the proposed standards for these two topics once the international projects are finalized.
- 17 The AcSB expects that future changes to IFRSs will be considered to determine if they are appropriate, in whole or in part, for Canadian private enterprises. There are clear advantages if Canadian GAAP for publicly accountable enterprises and private enterprises evolve in a consistent manner. Input received from stakeholders in response to the 2007 ITC supports the evolution of the standards for private enterprises towards IFRSs, largely on the grounds that doing so will minimize confusion in the marketplace and minimize educational and training costs. The same approach will be taken in making future changes to the proposed standards as was the case in their initial development.
- 18 In discussing the proposed approach at roundtable meetings, several stakeholders were concerned that the standards being developed would be a short-term solution and that the AcSB would adopt IFRSs or the IFRS for small and medium-sized entities (SMEs) for this sector shortly after publicly accountable enterprises had completed their transition to IFRSs. The AcSB notes that this will not be the case. Applying the proposed standards for only a few years before adopting a different set of standards would not pass a cost/benefit test for the AcSB or its stakeholders. However, consistent with good practice, the AcSB will periodically evaluate whether the new standards remain the most appropriate for Canadian private enterprises. The AcSB will

undertake such an evaluation no sooner than five years after publication of the final standards.

CHANGES MADE TO CURRENT STANDARDS — RECOGNITION, MEASUREMENT AND PRESENTATION

- 19 The various consultations and feedback from stakeholders during 2007-2008 indicated that only a limited number of specific issues in existing Canadian GAAP caused significant difficulty to private enterprises. Therefore, the AcSB decided to focus on these critical areas in considering the need for changes from current standards.
- 20 The AcSB compiled a list of the most significant issues based on:
 - (a) past experience with differential reporting;
 - (b) input received during the development of the CICA's proposed "Framework for Owner-managed Enterprises," and responses to that document; and
 - (c) consultations and feedback from stakeholders.
- 21 These significant issues are:
 - (a) asset retirement obligations;
 - (b) classification of callable debt;
 - (c) consolidations, joint ventures and significantly influenced investees;
 - (d) employee future benefits;
 - (e) financial instruments;
 - (f) future income taxes;
 - (g) impairment of goodwill and other intangible assets;
 - (h) internally developed intangible assets;
 - (i) leases; and
 - (j) stock-based compensation.
- 22 To ensure that it was complete, this list was discussed at various roundtable meetings and other consultations, and also posted on the AcSB website. The AcSB decided that, for the initial version of the standards, in order to meet the objective of timely completion of the project, these are the only areas where substantive changes in recognition, measurement, and presentation requirements will be considered. Accordingly, the AcSB proposes to collect all further issues and consider them for future updates to the proposed standards.
- 23 Proposed changes to existing requirements were considered based on cost/benefit considerations. The AcSB noted that "costs" should include preparation costs, communication costs, specialized expertise costs, and related assurance costs. Costs include not only preparer costs but the costs to users of receiving inadequate information and having to potentially understand several sets of standards. In addition, the AcSB considered the costs related to education and training, specifically as they relate to the proposed standards being different from IFRSs.
- 24 "Benefits" were assessed in relation to user needs, specifically whether the information conveyed under an existing accounting standard, as it relates to a particular issue, is of benefit to financial statement users in this sector. The AcSB relied on the information collected during its previous research into user needs, as well as the perspectives of the users on the special Advisory Committee composed to provide input on this project, to guide its assessment

of benefits. The AcSB's research indicated that creditors are the most frequent user of private enterprise financial statements. Other users, such as minority shareholders and guarantors, are encountered much less frequently in practice. Accordingly, while the needs of other users were considered, the needs of creditors were given the most weight. In general it appears that many users can get additional financial information from an enterprise, beyond that contained in the financial statements.

- 25 The ED proposes significant change in the following areas. The discussion below notes the rationale for the proposed changes.

Asset retirement obligations

- 26 Some financial statement preparers believe that calculating asset retirement obligations is complex and costly, without commensurate benefit to users. Some have suggested that enterprises be allowed to accrete the obligation over time on a straight-line basis in a manner similar to the accounting used prior to the issuance of ASSET RETIREMENT OBLIGATIONS, Section 3110. The AcSB noted that the liability recorded in the balance sheet under an accretion approach is not a reliable measure of the asset retirement obligation. Accretion was considered and rejected in adopting Section 3110. The AcSB does not believe that there should be a different conclusion based on whether the enterprise is public or private.
- 27 Existing Section 3110 requires initial measurement of asset retirement obligations at fair value and provides detailed guidance on how this fair value should be estimated. Certain of the requirements create difficulties for many private enterprises. For example, a credit-adjusted risk-free discount rate and a profit margin if the company itself will perform the work to satisfy the obligation are factors that can be difficult to determine. From a benefits perspective, users noted little value in some of the specific requirements regarding the fair value measurement of an asset retirement obligation, recognizing measurement of such an obligation can involve significant estimation. Their preference was for a measurement based on a less prescriptive "best estimate" approach.
- 28 Given this assessment of costs and benefits, and a desire for the proposed standards to be easier to apply and provide scope for professional judgment, the ED proposes adoption of the relevant provisions of International Financial Reporting Standard IAS 37, "Provisions, Contingent Liabilities and Contingent Assets." Accordingly, asset retirement obligations would be measured at the end of each period at the best estimate of the future expenditures required to settle the present obligation. The measurement does not require credit adjusted discount rates or estimated profit margins. An added benefit is that this increases convergence with standards that will be applicable to publicly accountable enterprises after adoption of IFRSs.

Consolidations, joint ventures and significantly influenced investees

- 29 SUBSIDIARIES, Section 1590, currently includes a differential reporting option that allows subsidiaries to be accounted for on either the cost or equity basis instead of being consolidated. The scope of the differential reporting option in Section 1590 extends to ACCOUNTING GUIDELINE AcG-15, Consolidation of Variable Interest Entities. INVESTMENTS, Section 3051, and INTERESTS IN

JOINT VENTURES, Section 3055, contain similar differential reporting options for investments in which there is significant influence and interests in joint ventures.

- 30 The AcSB understands that these differential reporting options have been widely used in practice, and also that the cost/benefit arguments considered in creating these options have remained substantially unchanged. Accordingly, the ED proposes that these alternatives be included in the standards for private enterprises.
- 31 The AcSB understands that AcG-15 can be problematic to apply, often requiring significant effort to determine whether an enterprise has a variable interest in another entity and, if so, whether that entity should be consolidated. The AcSB notes that there is currently an international project on consolidations that will address consolidation of variable interest entities. Once the international project is complete and a new standard issued the AcSB will consider whether private enterprise standards should include similar guidance. Given that an enterprise can avoid this issue by preparing non-consolidated financial statements and the imminent publication of new standards in this area, AcG-15 has been retained in the proposed standards.

Employee future benefits

- 32 The AcSB understands that the vast majority of private enterprises do not have traditional defined benefit pension plans for their employees. However, in recent years individual pension plans (IPPs) have been used increasingly by private enterprises and the vast majority of IPPs are defined benefit plans. The beneficiaries of such plans are frequently the owner-managers of an enterprise, but it is not uncommon for others such as a key employee or a minority equity owner to be beneficiaries.
- 33 The issue is that accounting for such plans in accordance with existing standards can be complex and costly. Accounting for defined benefit plans currently involves obtaining an actuarial valuation for accounting purposes in addition to that required for regulatory purposes. Discussions with actuaries and practitioners indicated that the costs of this additional valuation range from \$500-\$1,500. Setting up and maintaining the accounting for such plans can add further costs. These costs are often significant in relation to the size of the IPP.
- 34 Some stakeholders have suggested that private enterprises should be allowed to account for such plans on a cash basis, (i.e., expense the contributions as they are made). The AcSB noted that accounting for defined benefit plans on a cash basis would result in not recognizing a pension liability for an underfunded plan that will require future contributions to fund obligations incurred prior to the current year end. Accordingly, the AcSB rejected accounting for such plans on a cash basis.
- 35 Users generally view plans structured for the benefit of a controlling owner (controlling owner plans) as a different type of liability than liabilities under a defined benefit plan for employees. A controlling owner plan can be extinguished at the owner's discretion, without repercussion to the enterprise. In addition, it was noted that it is common practice that these plans are unwound when there is a change in control. On this basis, users view such

plans as tax-planning arrangements and are generally less interested in understanding the reported amount of the obligation. Users did not believe that IPPs whose beneficiaries were employees or minority shareholders shared the same characteristics as controlling owner IPPs.

- 36 The AcSB agreed that it should consider simplification in respect of controlling owner plans. In deciding what qualified as a controlling-owner plan, it was noted that, for tax planning purposes, IPPs were often created for the spouse of the controlling owner or with both the controlling owner and his or her spouse as beneficiaries. Limiting a controlling owner plan to those in which the controlling owner was the sole beneficiary would result in many private enterprises still having to account for IPPs using full defined benefit plan accounting. Therefore, the AcSB decided that controlling owner plans should include plans whose beneficiaries are the controlling owner, his or her spouse, or both. The AcSB also considered whether to include IPPs in which the beneficiaries include key employees or minority owners but noted that the controlling owner could not unilaterally amend or extinguish this type of IPP and that any attempt to alter a plan may involve the enterprise in a bargained settlement or even, in some cases, litigation.
- 37 The AcSB agreed that an alternative approach to accounting for controlling owner plans was justified based on cost/benefit considerations. AcSB members noted that such plans were required to have an actuarial valuation for funding purposes and that this might be used for accounting purposes thus avoiding the cost of an additional valuation for accounting purposes. Thus, there will be pension liability recorded. However, it will be based on the funding valuation. The frequency of funding valuations varies by jurisdiction but an IPP does not necessarily have a valuation each year. The AcSB agreed that in years in which an actuarial valuation of the obligation was not performed, the obligation could be estimated and included guidance on how this should be done. However, the AcSB was concerned that it was possible that an IPP might not have a funding valuation for several years and, as a result, the estimate of the obligation may become inaccurate. Therefore, it decided to require that a funding valuation be carried out at least once every three years, with disclosure of the effective date of the most recent actuarial valuation for funding purposes.
- 38 The AcSB also considered accounting related costs of accounting for defined benefit plans, specifically as they relate to deferral of gains and losses. Existing accounting permits the deferral of actuarial gains and losses and past service costs, with the deferred amounts being amortized into income over time. This requires accounting effort to keep track of the deferred amounts and to calculate the appropriate amortization each period. Users have told the AcSB that they use the full pension obligation in their analysis and that deferring actuarial gains and losses and past service costs is not useful to them. Therefore, the AcSB decided that the amount reported in the balance sheet for a controlling owner plan should be the net of the pension obligation and the plan assets at the balance sheet date, with no amounts being deferred. The full effect of any change in the net plan asset or obligation would be reported in income.
- 39 The AcSB noted that a controlling owner plan might be in a net asset position (i.e., the plan assets might be greater than the pension obligation). Consistent with the intent that the proposed standards be more principles based, the AcSB

decided to require that a valuation allowance be recognized for any excess of the plan surplus over the amount expected to be recoverable by the entity but not to require that the specific guidance provided on this issue in EMPLOYEE FUTURE BENEFITS, Section 3461, be applied to controlling owner plans.

Financial instruments

- 40 There are several issues that led to the development of FINANCIAL INSTRUMENTS, proposed Section 3856:
- (a) The financial instrument standards for publicly accountable enterprises are complex and often require resources that are beyond those cost-effectively available to many private enterprises.
 - (b) Obtaining fair value estimates for financial instruments that are not traded in an active market requires sophisticated financial modeling and access to a variety of market price sources.
 - (c) Determining impairment losses on financial instruments is complex due to multiple models in existing standards.
 - (d) The existing hedge accounting model, designed for publicly accountable enterprises, increases the number of fair value measurements and imposes extensive documentation and analysis requirements.
- 41 Existing requirements for financial instruments are scattered across a number of existing standards. One of the AcSB's objectives in developing proposed Section 3856 was to provide all of the requirements in a single Section. Proposed Section 3856 addresses issues covered in the following existing Handbook material:
- (a) ACCOUNTS RECEIVABLE, Section 3020;
 - (b) IMPAIRED LOANS, Section 3025;
 - (c) FINANCIAL INSTRUMENTS — RECOGNITION AND MEASUREMENT, Section 3855;
 - (d) FINANCIAL INSTRUMENTS — DISCLOSURE AND PRESENTATION, Section 3861;
 - (e) FINANCIAL INSTRUMENTS — DISCLOSURES, Section 3862;
 - (f) FINANCIAL INSTRUMENTS — PRESENTATION, Section 3863
 - (g) HEDGES, Section 3865;
 - (h) ACCOUNTING GUIDELINE, AcG-4, Fees and Costs Associated with Lending Activities;
 - (i) ACCOUNTING GUIDELINE, AcG-12, Transfers of Receivables;
 - (j) ACCOUNTING GUIDELINE, AcG-13, Hedging Relationships;
 - (k) EIC 70, "Presentation of a Financial Instrument Labelled as a Share When a Future Event or Circumstance May Affect the Issuer's Obligations;"
 - (l) EIC 101, "Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements;"
 - (m) EIC 149, "Accounting for Retractable or Mandatorily Redeemable Shares;" and
 - (n) EIC 158, "Accounting for Convertible Debt Instruments."

Basic principles

- 42 The AcSB confirmed that most aspects of the principles underlying the accounting standards for financial instruments for publicly accountable enterprises should apply to private enterprises for the following reasons:

- (a) Financial instruments represent rights or obligations that meet the definitions of assets or liabilities and should be reported in financial statements.
- (b) Fair value is the most relevant measure for financial instruments and the only relevant measure for derivative instruments.
- (c) Only items that are assets or liabilities should be reported as such in financial statements.
- (d) Special accounting for items designated as being hedged should be provided only for qualifying items.

Modifications to these principles have been made only when the cost to apply the principle exceeds the benefit to the users of private enterprise financial statements. The presumption that fair value is the best measurement for financial instruments is waived in many cases on the basis that its usefulness to the readers of the financial statements is not supported relative to the cost to obtain the information.

Minimum number of alternative treatments

- 43 Alternative treatments reduce comparability in financial reporting between enterprises in similar businesses. Users incur increased costs to analyze financial statements and draft appropriate loan agreements. As noted in paragraph 14, users prefer consistency in treatment among similar enterprises. Existing FINANCIAL INSTRUMENTS — RECOGNITION AND MEASUREMENT, Section 3855, contains numerous choices, many of which must be addressed on a transaction-by-transaction basis. Proposed Section 3856 limits alternative treatments to:
- (a) a choice of measurement technique when an enterprise issues convertible debt; and
 - (b) a choice to apply hedge accounting.

Transaction costs

- 44 Proposed Section 3856 requires that all transaction costs to issue, acquire, sell or settle financial assets and liabilities be expensed as incurred. The AcSB considered two alternative treatments for transaction costs. International Financial Reporting Standard IAS 39, *Financial Instruments: Recognition and Measurement*, requires transaction costs related to financial instruments that are measured at fair value with gains and losses recognized in net income to be expensed as incurred and all other transaction costs to be included in the initial carrying amount of the financial instrument to which they relate. Existing Section 3855 is the same as IAS 39 for transaction costs related to financial instruments measured at fair value through net income but requires an entity to make an accounting policy choice for those related to all other financial instruments.
- 45 Transaction costs do not meet the definition of an asset as set out in FINANCIAL STATEMENT CONCEPTS, Section 1000, and do not reflect any underlying value of the associated asset or liability. When transaction costs related to a debt instrument are included in the carrying amount of the debt, they need to be amortized to net income over its life. Amortization through the effective interest method is confusing to many users and preparers. Advisory Committee members and other stakeholders stressed that preparers and users prefer a more direct link between interest reported in the income statement and the contractual terms of loans. Although the cash flow statement can be

used to reconcile cash interest expense with interest accrued, eliminating this step provides a cost savings both to the enterprise in eliminating the complexity of preparing and maintaining amortization schedules and to the user in reducing analysis time.

- 46 The proposed standard includes a definition of fees to assist in making the distinction between fees and transaction costs. In effect, fees are prepaid interest. Unlike transaction costs, they should be amortized over the period to which they relate as an element of interest expense. The standard is silent on the method of amortization. This gives enterprises the flexibility to choose the most cost-effective amortization method. Amortization amounts would be presented or disclosed separately to facilitate reconciliation to cash flow amounts.

Non-financial contracts

- 47 The AcSB decided that it was not cost-effective for private enterprises to analyze contracts to buy or sell non-financial items to determine whether they meet the definition of a derivative or contain features that meet the definition of a derivative. Stakeholders have advised the AcSB that most private enterprises enter into non-financial contracts as part of their normal operating activities. Analyzing these contracts is costly and not justified when the results are expected to reveal little or no use of derivatives.

Embedded derivatives

- 48 Existing Section 3855 requires fair value measurement for features embedded in contracts that meet the definition of a derivative but are not closely related to their non-derivative host. The AcSB decided this requirement was not cost-effective for private enterprises. However, proposed Section 3856 requires special treatment for embedded derivatives that are indexing or conversion features in a debt obligation. Conversion options are discussed in paragraphs 75-78.

Indexed debt

- 49 Users of private enterprise financial statements expressed a need to understand when the enterprise is exposed to potentially negative changes in expected future cash flows. Embedded derivatives that are expected to decrease future cash flows from financial assets are recognized and measured through the impairment requirements of the proposed standard. Proposed Section 3856 prescribes a simplified model to account for the potentially negative effect of embedded features in debt financing that index future payments to factors such as the value of the entity's equity or performance measures such as earnings before interest, taxes, depreciation and amortization. At each reporting date, the enterprise reports the higher of the amortized cost of the debt or the amount that would be payable if the indexing formula applied at that date. The adjustment is reported as a separate component of interest expense.

Redeemable shares issued in a tax planning arrangement

- 50 FINANCIAL INSTRUMENTS — DISCLOSURE AND PRESENTATION, Section 3861, and FINANCIAL INSTRUMENTS — PRESENTATION, Section 3863, provide private enterprises with a differential option to treat as equity mandatorily redeemable shares issued pursuant to a tax planning arrangement effected under one of

several specified sections of the Income Tax Act (Canada). Proposed Section 3856 will require these shares to be treated as equity. The AcSB believes most private enterprises elect equity classification using the differential option and sees little benefit to having an alternative.

- 51 The AcSB decided that the rationale for the existing differential option is consistent with the objectives of the standards for private enterprises. Although these shares meet the definition of a liability, their terms are constructed to achieve a tax effect. External lenders usually protect their loans by prohibiting redemption of the shares other than on the death of a shareholder by requiring the shares to be subordinated to all external financing. Lenders have advised that they classify the shares as equity for the purpose of conducting their analyses even if the differential option is not chosen. Classifying the shares as equity achieves consistency between enterprises. Lenders also believe presenting the shares as equity gives a more realistic picture of an enterprise since the shares tend to crystallize the value of the enterprise that is held in unrecognized intangible assets. Solvency and liquidity measures are misstated if the shares are classified as liabilities. Lenders are well aware of these circumstances because they train lending officers and engage lawyers to ensure loan agreements are structured appropriately.
- 52 The AcSB considered whether to accord equity treatment to all shares issued without an infusion of cash but determined that only those issued pursuant to the specified sections of the Income Tax Act (Canada) consistently behave in a manner analogous to equity. The AcSB also considered whether there are other arrangements that create shares that meet the criteria of the listed sections. The AcSB decided to limit the classification to those shares issued in certain tax planning arrangements because they do not involve financing in the traditional sense and it would complicate the standard to include appropriate limitations on the classification without the structure of the tax law restrictions. The AcSB views the required disclosures as essential to alert financial statement users to the potential for future cash outflows that these shares represent, should the preferred shareholders decide to retract them.

Trade date accounting

- 53 Proposed Section 3856 requires that all financial instruments be recognized on the date an enterprise becomes a party to a contract to buy or sell a financial instrument. Trade date accounting more accurately reflects the economic effects of transactions and is the only recognition date that provides transparency for derivatives.

Minimize use of fair value measurement

- 54 Stakeholders in the private enterprise sector have repeatedly stressed that there are significant costs to reporting fair value information for financial instruments other than those that are traded in an active market. These costs occur in obtaining prices and rates, calculating fair values and in additional costs of attestation. Proposed Section 3856 prescribes that financial assets and financial liabilities would be measured at cost or amortized cost with the exception of:
- (a) freestanding derivatives outside qualifying hedging relationships; and
 - (b) equities that are traded in an active market.

The proposed standard does not provide the ability to elect fair value treatment for any financial instrument because this would complicate the standard.

- 55 The AcSB believes that fair value is the only relevant measure for derivative financial instruments. The cost of a derivative is often zero, yet a derivative generally can be settled or sold at any time for its fair value. Without measuring derivative financial instruments at fair value, they are invisible on the balance sheet. Gains and losses, which may change disproportionately in response to market movements, are reported only when the derivative is settled or sold rather than in the period in which the change in fair value occurred. Information about the value of derivatives and the gains and losses resulting from changes in those values is essential for users of financial statements to understand the nature of the risk exposures associated with derivative financial instruments. However, the proposed hedge accounting model (see paragraphs 80-85) is constructed such that fair value measurement does not add information.
- 56 Proposed Section 3856 requires fair value measurement for investments in equities that are traded in an active market. The fair value of a debt instrument returns to the principal amount at its maturity so amortized cost measurement combined with knowledge of the interest rate on the instrument provides sufficient information to meet the needs of a financial statement reader. Unlike debt instruments, the fair value of equity instruments is unlikely to return to its cost to the investor. Fair value measurement provides the best indication of the future cash flows that could result from an enterprise's investment in an equity investment.
- 57 The AcSB noted that judgment is necessary in some cases to determine whether a particular security is an equity instrument that is traded in an active market. For example, the AcSB observed that investments that are conduits for traded securities, such as pooled or mutual fund units, might meet the criteria for fair value measurement if the investments are liquid and prices for the units reflect the net asset value of the underlying pool.
- 58 The proposed standard requires that debt instruments be measured at amortized cost. Lenders advised that the amortized cost of a debt instrument provides more relevant information than its fair value when analyzing the financial statements of a private enterprise — in many cases, when a private enterprise borrower invests in debt instruments, the investments are short term and the amortized cost approximates the effect on the entity's cash flows. Fair value measurement would require the enterprise to determine the current market rate for a similar investment maturing at the same time as the instrument held. This information is not always readily available and the effect of remeasuring short-term debt instruments is only material when there has been a substantial change in conditions.
- 59 Derivatives that are based on, and require settlement by delivery of, another entity's equity instruments for which fair value cannot be readily determined would be measured at cost. When the fair value of these instruments is not reliably measurable or difficult and costly to estimate, users' information needs are adequately met by qualitative information. Derivatives that are designated in qualifying hedging instruments are also measured at cost. The proposed hedge accounting model is discussed in paragraphs 80-85.

Investment companies

- 60 A private enterprise that is an investment company would be required to apply ACCOUNTING GUIDELINE AcG-18, Investment Companies, to its investments. The nature of an investment company's activities is such that fair value measurement provides better information to the readers of its financial statements.

Guarantees

- 61 Guarantees are similar to derivatives. However, determining whether a guarantee meets the definition of a derivative that is within the scope of Section 3855 can be complicated and costly. The proposed standard exempts all guarantees on the basis that:
- (a) it would be rare that a private enterprise adopting these standards would be involved with a guarantee that would have required derivative treatment;
 - (b) the requirements in CONTINGENCIES, Section 3290, continue to apply to the recognition, measurement and disclosure of the potential negative impacts of financial guarantees; and
 - (c) the disclosure requirements in ACCOUNTING GUIDELINE AcG-14, Disclosure of Guarantees, continue to apply.

Definitions

- 62 By combining the requirements of several existing Handbook Sections and by specifying the accounting treatment for various financial instruments without the ability to choose among optional treatments, the definitions are considerably simplified from those in the existing standards. A definition of "fees" has been added to help with the distinction between transaction costs and fees. Definitions applicable to the transfer of receivables guidance are contained in Appendix B of Section 3856 and are unchanged from those in ACCOUNTING GUIDELINE AcG-12, Transfers of Receivables.

Subsequent measurement

Fair value

- 63 Appendix A of Section 3856 provides guidance on the use of prices quoted in an active market. The AcSB believes that entities using derivatives other than in hedging relationships should have sufficient sophistication to either calculate fair values of those derivatives or to understand fair value information provided by bankers or professional advisors.
- 64 Proposed Section 3856 permits use of closing prices for measuring traded equities. This is the simplest and most accessible price information for these investments. Non-option derivatives would generally be measured using mid-market prices or rates. This approach is believed to be the most consistent with prices that would be supplied by banks. Mid-market prices might also be used for over-the-counter options in place of bid prices for purchased options and ask prices for issued options. The AcSB recognizes that option valuation is complex so the proposed standard permits some flexibility provided the price or rate chosen is applied consistently.

Amortized cost

- 65 The proposed standard permits presenting amortization as a separate component of interest income or expense in such a way that the amounts relating to amortization are shown separate from the cash interest accrued. The AcSB believes this flexibility will achieve cost savings and provide more useful information for affected enterprises.

Impairment

- 66 The existing standards that would be replaced by proposed Section 3856 contain varying impairment requirements. Some of these require fair value measurement to identify and measure impaired assets. The AcSB believes a single impairment model that avoids fair value measurement applied to all financial assets would be less costly to preparers and auditors and easier for users. Stakeholders advised that the allowance for doubtful accounts receivable is an important consideration for many private enterprises. Accordingly, an impairment model needs to permit assessment of groups of homogeneous assets and a write-down to an estimated recoverable amount, when appropriate. Section 3856 would require individual assessment of equity investments and any asset considered to be individually significant. Other assets, including accounts receivable, might be grouped on the basis of similar credit risk characteristics.
- 67 The AcSB decided that a financial asset should be considered impaired when an enterprise expects an unfavourable change in either the amount or timing of future cash flows from the asset. The enterprise should assess an asset (or group of assets) on the occurrence of an event or circumstance during the reporting period that might indicate such a change in cash flows. When an enterprise expects either that the asset will not be repaid in full or that repayment will be delayed, it would reduce, either directly or through an allowance account, the carrying amount of the asset to an amount it estimates would be recoverable. The model requires recognition of a loss when the enterprise observes an indication of impairment that is expected to result in a change in the amount and/or timing of the cash flows from the asset. Unlike some existing impairment requirements proposed Section 3856 does not require objective evidence of impairment.
- 68 The AcSB decided that the amount recognized as a loss should be the difference between the current carrying amount of the asset and the amount the enterprise could expect to receive in the most favourable outcome. This presumes the enterprise acts in the way that maximizes cash flow from holding the asset even if the enterprise expects to do otherwise to preserve the customer relationship.
- 69 Some of the existing impairment models do not permit an enterprise to reverse a previously recognized impairment loss in the event that the prospects of repayment improve. However, some models require an enterprise to assess whether the impairment loss is “other than temporary”. Although there is limited guidance on interpreting “other than temporary”, recognition of impairment losses is sometimes delayed or avoided when the entity believes the value of the asset will recover. The AcSB decided that a simpler model that avoided determining whether impairment losses are other than temporary would:

- (a) permit a single model that applies to all types of financial assets; and
- (b) avoid the complexity and cost associated with determining whether an impairment loss is other than temporary.

By removing the concept of other-than-temporary impairment losses and requiring reversals if conditions improve, the model will not disrupt current practice for creating an allowance for doubtful accounts.

- 70 The AcSB decided that the revised estimated cash flows of short-term receivables need not be discounted if the effect is expected to be immaterial. Stakeholders have advised that discounting complicates accounting, thereby increasing costs. The AcSB considered whether to exempt from discounting any receivables classified as current after recognizing any delay in expected payment but rejected this notion on the basis that the distinction between current and non-current is arbitrary and the effect of discounting within the year when interest rates are comparatively high could be material.

Derecognition

- 71 The requirements of existing ACCOUNTING GUIDELINE AcG-12, Transfers of Receivables, have been included in proposed Section 3856. Because these requirements only apply in special circumstances, they have been placed in Appendix B to the Section.
- 72 The AcSB is monitoring short- and long-term international and US projects to develop new guidance on derecognition of financial assets and will revise Appendix B, as appropriate, to align with best practice.
- 73 The guidance on derecognition of liabilities in existing Section 3855 has also been included in proposed Section 3856. Consistent with the requirement to expense all transaction costs, proposed Section 3856 would require costs incurred to restructure a financial liability to be expensed.

Liabilities and equity

- 74 As noted above, the requirements of existing Section 3863 have been incorporated into proposed Section 3856 with two significant modifications:
- (a) retractable preferred shares issued in a tax planning arrangement must be classified as equity (see paragraphs 50-52); and
 - (b) an option to convert the liability to equity may be measured as zero.

Convertible debt

- 75 Many stakeholders stated that the bifurcation of equity derivatives embedded in a debt instrument is a process that is expensive and produces information that is not relevant to users of private enterprises' financial statements. Many private enterprises grant equity options as a condition of obtaining equity financing. Venture capital lenders use the option both to obtain control over higher risk borrowers, if necessary, and to enhance the potential return from the loan.
- 76 When an enterprise is unable to obtain financing without providing a conversion option, there will be no market interest rate available for a loan with similar terms but without the conversion option. In these cases, it is difficult to measure the value of the option based on the fair value of the

debt without a conversion option. Measurement of embedded equity options directly often requires engaging valuation specialists.

- 77 Lenders have stated that, in analyzing financial statements, they add back to the liability the amount allocated to the equity component. Other financial statement users also prefer that the liability be measured at the face amount of the obligation. Accounting professionals advise that reviewing or auditing the amount allocated to the equity component is complicated and increases the cost of an assurance engagement.
- 78 The AcSB decided that convertible debt should be bifurcated to reflect the different economic characteristics of the components, consistent with existing Section 3863. However, the AcSB was persuaded that the equity component might be allocated little or no value on the basis of cost exceeding benefits. The proposed standard would require disclosure of the nature and terms of the feature.

Preferred shares

- 79 Proposed Section 3856 incorporates the guidance in Emerging Issues Committee Abstract EIC-149, “Accounting for Retractable or Mandatorily Redeemable Shares.” Stakeholders advised the AcSB that many private enterprises use retractable shares to protect the interests of continuing shareholders on the retirement or death of their partners. The Abstract has been helpful in distinguishing between shares that should be treated as liabilities and those that are treated as equity.

Hedge accounting

- 80 Hedge accounting involves exception treatment for either or both of the item creating a risk and the item providing the offset that neutralizes that risk. Hedge accounting is always optional but is only applied when accounting requirements for the two items create an accounting mismatch. To prevent abuse, hedge accounting requires strict adherence to a number of qualifying conditions. Stakeholders were divided on whether private enterprises need a hedge accounting model. However, the AcSB was advised that some private enterprises enter into hedging arrangements that would have significant effects on their reported operating results.
- 81 The AcSB decided to include a limited scope hedge accounting model that would not rely on fair value measurement to assist private enterprises that:
- (a) use forward contracts to offset the terms of purchase and sale contracts or future foreign currency cash flows;
 - (b) offset interest rate risk with interest rate swaps;
 - (c) offset both interest rate and currency risk with cross currency interest rate swaps; or
 - (d) have investments in self-sustaining foreign operations that are financed with foreign currency debt or hedged with foreign exchange forward contracts.

An enterprise would be required to disclose additional information about each hedging relationship that would alert a financial statement reader to the existence and effect of the hedging relationship.

- 82 Proposed Section 3856 contains qualifying criteria similar to that in existing Section 3865. However, there is no requirement to document a risk management strategy and relate the relationship to a risk management objective because these would be evident by the nature of each relationship. A hedging relationship can only qualify for hedge accounting if the critical terms of the hedging instrument match those of the hedged instrument. This ensures that the relationship will remain effective as long as the terms continue to match. Because the terms match, there is little, if any, difference in the income statement effect between this model and the fair value model in hedging standards for publicly accountable enterprises.
- 83 The proposed hedge accounting model would recognize the realized gain or loss on the hedging instrument as an adjustment of the carrying amount of the hedged item. When an interest rate swap is used to hedge periodic cash flows, the enterprise accrues the interest adjustment from each reset date to the settlement date to which it relates. This treatment most closely mirrors the recognition of accrued interest on the hedged item.
- 84 The AcSB decided against allowing futures contracts and options as hedging items for accounting purposes. Futures contracts rarely match the critical terms of a contract perfectly due to their standardized quantities and settlement dates. An enterprise that hedges with futures contracts must account for those contracts at fair value. Although options can be effective in protecting an entity against unfavourable changes in a market price or rate, the AcSB was concerned that the accounting model that would be necessary to reflect such arrangements would unduly complicate the standard. In particular, certain types of options would provide too much flexibility to qualify as matching the critical terms of the hedged item. Some AcSB members also concluded that the asymmetrical hedging that occurs with options was inconsistent with the concept of neutralizing risk.
- 85 Non-derivative financial instruments are only permitted as hedging items for the foreign currency risk in the net investment in a self-sustaining foreign operation. Since the foreign exchange gains and losses on non-derivative financial instruments are recognized in net income, other than those relating to a net investment, there is no income statement mismatch if the terms of a foreign currency asset exactly match those of a foreign currency liability. Foreign currency gains and losses on a net investment in a self-sustaining foreign operation are recognized in equity in accordance with FOREIGN CURRENCY TRANSLATION, Section 1651. Accordingly, special hedge accounting treatment is available to ensure that foreign currency gains or losses on financial liabilities financing these investments can be recognized in net income at the same time as the corresponding foreign currency gains and losses on the investments.

Future income taxes

- 86 FUTURE INCOME TAXES, Section 3465, currently includes a differential reporting option allowing entities to use the taxes payable method. From a cost perspective, the arguments supporting this differential reporting option remain largely unchanged. In respect of benefits, there continues to be a diversity of views with regard to the usefulness of accounting for future income taxes. Many users of private enterprises' financial statements believe that accounting for future income taxes produces very little in the way of useful information.

Others believe that using the taxes payable method produces misleading information because it provides no information on whether cash tax payments will change significantly in future years for reasons other than changes in the level of income. User views in respect of accounting for future income taxes appear to be partly situational, depending on the size of the investment, the type of industry and also the characteristics of the enterprise. Based on their experience with differential reporting, users who argue that the future income taxes method provides significant value believe that in many cases they would be able to require enterprises they are involved with to follow the future income taxes method. On this basis, these users were supportive of permitting the taxes payable method provided there is note disclosure similar to that currently applicable under that method.

- 87 The AcSB understands that some stakeholders do not use the current taxes payable differential reporting option on the grounds that the accompanying disclosures require essentially as much effort as applying the future income tax method. The AcSB notes that this view appears to stem from a misreading of the current disclosure requirement, specifically the reconciliation in paragraph 3465.106(d). The reconciliation is between the income tax expense reported and the amount that would result if the statutory rate were applied, not the expense if the future income taxes method was used. The AcSB has been advised that this reconciliation can be performed very readily once the income tax return has been prepared. To assist financial statement preparers, an example of this reconciliation has been included in the proposed income tax standard.

Impairment of goodwill and other indefinite-lived intangibles

- 88 GOODWILL AND INTANGIBLE ASSETS, Section 3064, requires goodwill and intangible assets with an indefinite life to be recorded at cost, subject to write-down for impairment. These assets are not amortized. This treatment places considerable emphasis on the impairment test. Private enterprises have often found this treatment a difficult issue since the standard requires an annual impairment test and the impairment test can be costly to perform.
- 89 Some have suggested that an amortization approach be adopted for accounting for goodwill and other indefinite-lived intangibles. The AcSB noted that this approach does not eliminate the need for impairment testing, although the likelihood of impairment would be reduced the longer the asset was held, as the balance reduced through amortization. The AcSB rejected this alternative because amortizing assets that have an indefinite life results in understating income and the assets on the balance sheet.
- 90 Others have suggested that goodwill and other intangible assets should not be recognized on a private enterprise's balance sheet because there is often significant uncertainty with respect to their value. Some stakeholders expressed strong disagreement with such an approach, noting that goodwill and other intangible assets meet the definition of an asset and immediate write-off would be inconsistent with the treatment of assets generally. The definition of an asset does not change depending on whether the party holding it is public or private. The AcSB agrees with this view and accordingly has rejected a non-recognition approach.

- 91 While existing Section 3064 requires an annual assessment of impairment, it contains a differential reporting option permitting impairment testing on an “events and circumstances” basis. The AcSB understands that this differential reporting option is well accepted in the marketplace, and also that the cost/benefit arguments supporting it have not changed significantly since its introduction. On this basis, the ED proposes that the events and circumstances trigger be embedded into the proposed standards for private enterprises as the mandatory approach.
- 92 Further simplification is proposed in respect of how impairment testing is to be performed. Existing Section 3064 has a two-step approach to determining impairment of goodwill. The first step requires that the carrying amount of the reporting unit containing the goodwill being tested to be compared to its fair value. If the fair value of the reporting unit is less than its carrying amount, then the fair value of goodwill is compared to its carrying amount. Determining the fair value of the goodwill can be costly as it requires obtaining fair values for all other assets and liabilities in the reporting unit. (The fair value of goodwill is the difference between the fair value of the reporting unit and that of its assets, other than goodwill, less its liabilities.)
- 93 The AcSB observed that International Financial Reporting Standard IAS 36, “Impairment of Assets,” does not include the second step but assumes any shortfall identified in the first step is attributable to goodwill. Adopting this approach eliminates the need to fair value the individual assets and liabilities in the reporting unit. Therefore, the ED proposes that goodwill be written down by any excess of the carrying amount of the reporting unit over its fair value.

Internally developed intangible assets

- 94 GOODWILL AND INTANGIBLE ASSETS, Section 3064, requires entities to assess whether development costs of identifiable intangible assets meet a number of criteria and, if so, to capitalize these costs. Some have suggested that this evaluation is costly, and that private enterprises should be given the ability to expense these costs without evaluating them against the criteria.
- 95 In discussing this issue, the AcSB noted that internal costs associated with evaluating the criteria set out in Section 3064 were not necessarily burdensome. Management should be able to evaluate these criteria as a result of knowing the business. However, it was noted that there may be some costs related to obtaining assurance on the application of these criteria.
- 96 From a benefits perspective, some users (particularly creditors), ascribe little value to so-called “soft assets” such as internally developed intangible assets. Users recognize that these may meet the definition of an asset and may have economic benefits. Therefore, recognition of these assets does have information value. Nevertheless, many, but not all, users of private enterprise financial statements generally ignore or heavily discount internally generated intangible assets in their analysis of an enterprise’s financial position.
- 97 The AcSB noted that the criteria used to evaluate whether internally generated intangible assets should be capitalized relies heavily on management judgement and, in practise many entities expense all such costs. As a result, users do not know if costs are expensed because they do not meet the criteria

for capitalization or because the enterprise has, *de facto*, adopted a practice of expensing all internal costs related to intangible assets.

- 98 Given this assessment of cost/benefit, as well as a desire to make the enterprise's accounting policy as transparent as possible, the AcSB agreed to permit a choice in accounting for internally developed intangible assets. The AcSB believes that requiring enterprises to disclose their accounting policy choice will increase transparency. An enterprise may choose to capitalize eligible costs as set out in existing Section 3064 or, alternatively, expense such costs as incurred.
- 99 The AcSB considered whether this choice should be applied consistently to development costs for all internally generated intangible assets or, alternatively, on a project-by-project basis. This was raised primarily in the context of the effort and ability of enterprises to restate prior period financial statements should the enterprise choose to change its policy choice in the future.
- 100 This application issue was specifically discussed at several of the roundtable sessions held around the country, with mixed feedback. The majority of constituents understood the appeal of application on a project-by-project basis but felt strongly that the need for consistency of application meant that the choice should be applied uniformly.
- 101 In addition, the AcSB noted that while the general requirement in ACCOUNTING CHANGES, Section 1506, is to restate prior years when there is a change in accounting policy, the Section permits prospective treatment when restatement is impracticable because the enterprise "cannot determine the cumulative effect of applying the policy to all prior periods." The AcSB believes that this provision in Section 1506, together with an appropriate application of the materiality concept, addresses the concerns raised and therefore concluded that this accounting policy choice must be applied to all projects in a consistent manner.

Stock-based compensation

- 102 The AcSB has been informed that private enterprises generally find measuring the fair value of stock-based compensation to be costly, primarily in valuing the enterprise's stock as an input to an option valuation model. Some entities note that, for attestation purposes, they engage third party business valuers to validate the value of the enterprise's stock.
- 103 Some stakeholders have suggested that private enterprises should be allowed to use a "disclosure-only" option, (i.e., avoid recognition of stock-based compensation or, alternatively use the intrinsic method in accounting for stock-based compensation).
- 104 Creditors generally have little interest in information about the cost of stock-based compensation, unless such plans have significant cash flow implications (for example, under a cash-settled stock appreciation right). Equity investors, particularly minority shareholders, have expressed interest in the cost of stock compensation, largely in understanding the degree to which it has a dilutive effect. While the AcSB, in developing this ED, recognized that creditors are the most frequent user group in this sector, it cannot ignore the needs of equity

investors. By the very nature of the transaction, it is much more likely that an enterprise that issues stock-based compensation will have users of their financial statements who are equity investors.

105 The AcSB agreed that a disclosure only approach would not provide useful information to financial statement users, as an enterprise would not record any cost for compensation that has real value. Recognition of stock-based compensation has gained wide acceptance, the AcSB believes that there is no basis for different recognition on this issue based on the accountability (i.e., public vs. private) of the enterprise. Accordingly, the AcSB does not believe that such an approach is appropriate.

106 The AcSB considered but rejected the intrinsic method as it would not appear to offer relief from a cost perspective. One of the inputs in applying the intrinsic method is the fair value of the underlying equity. The intrinsic method involves remeasurement at each balance sheet date. Accordingly, the intrinsic method would not be responsive to stakeholder concerns.

107 In examining the costs of accounting for stock-based compensation, the AcSB noted that the existing standard does not require a third-party independent valuation. In issuing a stock option, an enterprise would normally have assessed the fair value of its underlying equity, even if only at a basic level, to comply with corporate governance requirements and determine whether the option was written in, out, or at the money.

108 The AcSB also noted the importance of volatility as an input in calculating the fair value of an option. For an out-of-the-money option, volatility may be the principal element of its fair value. Excluding volatility will generally result in significantly misstating the value of a stock option. Accordingly, the ED proposes deleting the minimum value method from the existing standard. Recognizing that most private enterprises cannot estimate the volatility of their own equity without significant cost and effort, the ED proposes adoption of the calculated value method, which permits an enterprise to use the volatility of an appropriate sector index as a proxy for the volatility of its own equity. The AcSB notes that such indices are readily available and, therefore, believes that private enterprises will have no major cost issues with respect to using the calculated value method and, in particular, use of the calculated value method should not require the assistance of third-party experts to do so.

SIGNIFICANT ISSUES ON WHICH NO CHANGES ARE PROPOSED

Current classification of callable debt

109 Emerging Issues Committee Abstract EIC-122, “Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced,” requires debt that is callable at the option of the holder to be classified as a current liability unless certain requirements are met. The overall issue with current classification is the effect on the balance sheet — that management’s view with respect to liquidity is not consistent with that reflected in the financial statements.

110 A number of constituents believe that, in many cases, current classification of such debt misrepresents the nature of the liability. For example, many demand bank borrowings are accompanied by a non-binding long-term

repayment schedule. The borrower expects that the lender will not exercise the call feature as long as repayments are made as scheduled and thus current classification is inconsistent with the expectations of the borrower. Financial statement preparers have suggested that such debt be classified on the basis of management's expectations of the timing of repayment.

- 111 Users generally find current classification provides the most useful information. This is particularly the case if the debt is owed to another party (i.e., there is more than one creditor involved with the entity). Some lenders have been surprised to find amounts owing to them classified as current, but indicate that they can easily adjust for this in their analysis of the borrower's financial position. The AcSB confirmed that callable debt in general meets the definition of a current liability and noted that there are no direct costs associated with presenting this debt as current rather than long-term. There may be some additional communication required to third parties who receive the financial statements but these costs should generally be non-recurring. The AcSB has concluded that there is no logical basis for classifying such debt as long-term since no party other than the lender can determine whether the debt will be called in the current period or not.
- 112 The guidance in EIC-122 has been carried forward into CURRENT ASSETS AND CURRENT LIABILITIES, Section 1510, of the proposed standards. An example of how such debt might be presented in the balance sheet to make the nature of the debt clearer is provided with the proposed standards.

Leases

- 113 Some stakeholders have suggested that the standards for private enterprises give lessees the option to account for all leases as operating leases. Users have repeatedly, and strongly, stated that they find considerable information value in capital lease accounting, with some users advocating that all leases should be capitalized. An "all capital" approach is the direction being proposed in the IASB/FASB Discussion Paper, "[Leases — Preliminary Views](#)" issued in March 2009.
- 114 The Advisory Committee did not believe that the costs associated with accounting for capital leases are overly burdensome. The AcSB decided that the standards for private enterprises should include the existing accounting requirements for capital leases. An "all capital" approach was not considered as the existing Handbook was used as the starting point for development of the proposed standards.

BUSINESS COMBINATIONS

- 115 BUSINESS COMBINATIONS, Section 1582, CONSOLIDATED FINANCIAL STATEMENTS, Section 1601, and NON-CONTROLLING INTERESTS, Section 1602, were incorporated into the existing Handbook as part of the January 1, 2009 update. The effective date is years beginning on or after January 1, 2011, with earlier adoption permitted. The proposed standards for private enterprises include these new Sections rather than BUSINESS COMBINATIONS, Section 1581, and CONSOLIDATED FINANCIAL STATEMENTS, Section 1600. If a private enterprise early adopts the standards for private enterprises then it would have to apply these business combinations standards prior to 2011. The AcSB made this decision for the following reasons:

- (a) The proposed standards are fundamentally a new basis of reporting. It would be unnecessary, and possibly confusing, to have two sets of standards dealing with the same transaction on initial development of a new financial reporting system.
- (b) The AcSB understands that business combinations are relatively uncommon transactions within the private enterprise sector, and that typically an enterprise learns the applicable accounting standards for this transaction as the transaction is undertaken. Therefore, it is unlikely that many enterprises will need to learn the new business combinations standards immediately.
- (c) In certain respects, the new business combinations standards are simpler than the superseded standards.

DISCLOSURES

- 116 The existing suite of disclosure requirements in the Handbook were developed to serve the needs of both public and private enterprises with many disclosures developed to meet the specific needs of publicly accountable enterprises, particularly equity investors. As a result, some disclosures may not serve the needs of users in the private enterprise sector. Many stakeholders have noted that private enterprises suffer from “disclosure overload”, in which there are so many disclosures that it has become difficult to understand the financial statements as a whole. Accordingly, the AcSB undertook a complete re-evaluation of the disclosure requirements for the proposed standards, based on the needs of financial statement users and circumstances prevailing in private enterprise sector.
- 117 The AcSB understands that the most frequent financial statement user in the private enterprise sector, creditors, often have the ability to request (and generally receive) additional information from the enterprise. On this basis, the goal of the disclosure requirements for the proposed standards is to provide enough information for users to understand the financial statements and be able to make informed enquiries regarding financial statement items or transactions without imposing costs of preparing unnecessary disclosures. Cost/benefit considerations were used to aid in the creation of the proposed standards. In assessing cost/benefit, the AcSB noted that individual disclosure requirements are only part of the issue. It is the overall number of disclosures that can be problematic to stakeholders in this sector.
- 118 This approach was not embraced by all financial statement users consulted during the development of the proposed standards. There are a number who noted that getting information from an enterprise may result in transactions taking additional time and costing the enterprise through a delay in completing a transaction or an increased cost of capital, or both. These concerns were considered in developing the proposed disclosures.
- 119 The proposed new standards would place increased reliance on the general disclosure requirements in GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION, Section 1400, in ensuring that enterprises provide sufficient information to present fairly their financial position and results of operations of an enterprise in accordance with GAAP. As a result of the increased importance of the overall “fair presentation” requirements, it may be the case that, in practice, there is less reliance placed on disclosure checklists and rote compliance with detailed requirements.

- 120 In developing the disclosure requirements in the proposed standards, the existing disclosure requirements were first categorized as follows:
- (a) accounting policies chosen and any changes thereto;
 - (b) risks and uncertainties (for example, going concern);
 - (c) unusual events (for example, subsequent events);
 - (d) assumptions used in developing an accounting estimate;
 - (e) reconciliations of one financial statement amount to another; and
 - (f) detailed breakdowns of amounts in the financial statements.
- 121 Users have noted that the first three are the most important types of disclosures, for the following reasons:
- (a) accounting policies are necessary to understand and analyze the financial statements;
 - (b) risks and uncertainties are important to evaluate the likelihood of an enterprise meeting its cash flow obligations; and
 - (c) unusual events are important in understanding the financial statements and the changes from prior periods.
- 122 The Advisory Committee reviewed each of the disclosure requirements in the existing standards being carried forward using these criteria. On each topic, user members on the Advisory Committee were asked to consider what information they would need in terms of disclosures. The three types of disclosures listed above provided guidance for developing the disclosure requirements in the proposed standards but they were not applied as hard and fast criteria. There are a number of proposed disclosures that fall outside of these “critical” categories.
- 123 The approach in developing the disclosure requirements has resulted in a significant reduction in the number of specific requirements. The proposed standards contain approximately one-half the number of specific disclosure requirements in the existing Handbook. However, there are two new disclosure requirements that users identified as being of particular value for private enterprises even though they are not required in the existing handbook. These are the disclosure of compensation of key management personnel, and certain government remittances and whether any such remittances are in arrears.
- 124 In respect of compensation of key management personnel, users have noted that they are particularly interested in this information in order to evaluate the cash flows of the entity. This disclosure is particularly relevant to private companies as there is a tax incentive for compensation to be paid so as to reduce the enterprise’s taxable income to a certain amount. Thus, the income statement may not accurately reflect the enterprise’s underlying profitability. Preparers noted a reluctance to disclose this information as they do not want such to be widely known. Others responded to this concern by noting that private enterprises generally do not widely distribute their financial statements, and can control who receives them. In respect of government remittances and the status thereof, creditors note that certain such liabilities receive super-priority status over secured creditors and, accordingly, they are interested in such amounts. The AcSB noted that there is little direct cost associated with these new disclosures.

EIC ABSTRACTS

- 125 Emerging Issues Committee Abstracts of Issues Discussed, as they exist in the Handbook, have been excluded from the proposed standards. Many Abstracts are based on rules-oriented elements of US GAAP and, as a result, are heavily “rules” oriented and very detailed. The AcSB has concluded that in creating a principles-based financial reporting system for private enterprises, it is not appropriate to include the type of detailed guidance contained in the Abstracts. However, there are some Abstracts that contain significant guidance that is relevant to this sector and should be retained in the proposed standards. This guidance has been incorporated into the individual standards where appropriate.
- 126 The following guiding criteria were used in reviewing Abstracts to identify elements for incorporation into the proposed standards:
- (a) Retain only significant guidance. The standards for private enterprises should be principles-based and should not contain a significant amount of detailed guidance;
 - (b) Retain Abstracts, or portions thereof, that address issues of particular importance to private enterprises. The AcSB has conducted a significant amount of research into the needs of financial statement users in this sector, and also on the issues commonly encountered by private enterprises. The knowledge gained has been used to identify Abstracts interpreting issues that are important to private enterprises;
 - (c) Retain components of Abstracts that fill in gaps in the overall financial reporting system; and
 - (d) Omit disclosure requirements. Disclosures were separately re-evaluated in developing the proposed standards.
- 127 In applying these criteria, the AcSB identified 17 issues addressed in existing Abstracts for retention in the proposed standards. The majority of retained issues are in respect of accounting for leases, related party transactions, revenue and current assets and current liabilities.

EXCLUDED SECTIONS AND GUIDELINES

- 128 As noted above, the proposed standards have been developed from the existing Handbook. There are a number of individual Sections and Guidelines in the existing Handbook that are largely irrelevant to private enterprises. The AcSB proposes not to include these Sections and Guidelines in the proposed set of standards. The rationale for excluding these Sections and Guidelines is provided below.
- 129 The AcSB observed that, in respect of a number of excluded Sections and Guidelines, guidance can be found in IFRSs and, accordingly, that an enterprise would be able to refer to that guidance in accordance with the hierarchy of GAAP sources in *GENERALLY ACCEPTED ACCOUNTING PRINCIPLES*, Section 1100, should it wish to do so.

DIFFERENTIAL REPORTING, Section 1300

- 130 *DIFFERENTIAL REPORTING*, Section 1300, is no longer necessary as the proposed standards for private enterprises replace differential reporting.

SEGMENT DISCLOSURES, Section 1701

131 SEGMENT DISCLOSURES, paragraph 1701.08, states:

➤ *This Section should be applied by public enterprises, co-operative business enterprises, deposit-taking institutions and life insurance enterprises. Public enterprises are those enterprises that have issued debt or equity securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets), that are required to file financial statements with a securities commission, or that provide financial statements for the purpose of issuing any class of securities in a public market.*

132 Therefore, private enterprises are currently excluded from this Section.

133 Segment information does not appear to have significant value to users in the private enterprise sector. Paragraph 75 of the Background Information and Basis for Conclusions for INTERIM FINANCIAL STATEMENTS, Section 1751, notes that few private enterprise financial statement users have requested this information. Recent research into user needs confirms that there is little interest in having entities in this sector report segmented information. In particular, the majority of creditors do not appear to be interested in analyzing cash flows on a disaggregated basis.

INTERIM FINANCIAL STATEMENTS, Section 1751

134 INTERIM FINANCIAL STATEMENTS, paragraph 1751.02, states:

This Section applies to all profit-oriented enterprises that are required by law, regulation or contract to prepare interim financial statements in accordance with generally accepted accounting principles, or elect to do so. This Section does not mandate which enterprises are required to prepare interim financial statements, nor does it specify how frequently, or how soon after the end of an interim period.

135 Many stakeholders have noted that private enterprises rarely prepare interim financial statements in accordance with GAAP. While many users wish to see interim financial statements, the statements they are interested in, and accept, are internal financial statements that are not prepared in accordance with GAAP. These statements are often supplemented with other internal information such as aged accounts receivable listings and inventory listings. Also, stakeholders have noted that it is often not practical from either a cost or timeliness perspective for private enterprises to prepare interim financial statements in accordance with GAAP.

EARNINGS PER SHARE, Section 3500

136 EARNINGS PER SHARE, paragraph 3500.02, states:

➤ *An enterprise should present earnings per share information when it has:*

- (a) issued common shares or potential common shares that are traded in a public market (a domestic or a foreign stock exchange or in an over-the-counter market, including local and regional markets); or*
- (b) made a filing or is in the process of filing with a securities commission in preparation for the sale of those securities in a public market.*

137 Thus, entities that are non-publicly accountable enterprises are not required to present earnings per share information.

138 There has been no demand expressed by users for private enterprises to provide earnings per share information. Creditors are generally not interested in earnings per share information as they are typically concerned with aggregate cash flows. Since private enterprises generally have simple capital structures, a financial statement user would usually be able to calculate earnings per share information if they so desired.

EXTRAORDINARY ITEMS, Section 3480

139 In the course of reviewing the presentation requirements in respect of extraordinary items, the AcSB noted that many financial statement users in the private enterprise sector do not believe there is significant value to the information required by EXTRAORDINARY ITEMS, Section 3480. Stakeholders the AcSB consulted with agreed that extraordinary items are rare in practise. Given the significant time that often passes between the balance sheet date and publication of the financial statements, users note that they would expect to be told about an extraordinary item prior to receiving the financial statements. When the disclosure is of value, stakeholders believe that the “fair presentation” requirements in GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION, Section 1400, are sufficient to require entities to disclose extraordinary or unusual events separately. As a result, Section 3480 has not been included in the proposed standards. This also achieves harmonization with publicly accountable enterprises. IFRSs specifically prohibit extraordinary classification.

PENSION PLANS, Section 4100

140 Pension plans are, by definition, publicly accountable enterprises. Accordingly, PENSION PLANS, Section 4100, is outside the scope of the proposed standards.

FUTURE-ORIENTED FINANCIAL INFORMATION, Section 4250

141 The AcSB does not believe that FUTURE-ORIENTED FINANCIAL INFORMATION, Section 4250, is generally relevant to private enterprises. While many users are interested in obtaining future-oriented financial information, and may receive such information in the course of making investment decisions, this information is generally not prepared in accordance with the existing standard due to cost constraints. This Section was developed to meet the needs of the public securities markets, (i.e., inclusion of future-oriented financial information in prospectuses and other offering documents). Accordingly, it is not considered to be well-suited to private enterprises.

142 The proposed set of standards is for the purpose of preparing GAAP financial statements as described in FINANCIAL STATEMENT CONCEPTS, Section 1000. AcSB notes that this Section contains useful guidance, but also notes that such guidance is not consistent with this purpose.

Insurance standards (Section 4211, AcG-3, AcG-8 and AcG-9)

143 LIFE INSURANCE ENTERPRISES — SPECIFIC ITEMS, Section 4211, ACCOUNTING GUIDELINES AcG-3, Financial Reporting by Property and Casualty Insurance Companies, AcG-8, Actuarial Liabilities of Life Insurance Enterprises — Disclosure, and AcG-9, Financial Reporting by Life Insurance Enterprises deals with insurance enterprises. Insurance enterprises fall within the definition of publicly accountable enterprises and, therefore, will be required to follow IFRSs.

AcG-7, The management report

144 ACCOUNTING GUIDELINE AcG-7, The Management Report, provides the AcSB's views on the minimum content of a management report that acknowledges management's responsibility for financial information, but does not form part of the financial statements.

145 AcG-7 states that, when an enterprise's annual financial statements are distributed widely, a management report should be presented. An enterprise's financial statements are considered to be distributed widely when, for example, its securities are traded in a public market, it is required to file financial statements annually with a securities commission, or its financial statements are distributed to members or policyholders in the case of an enterprise such as a credit union or a life insurance enterprise.

146 The AcSB noted that, in general, the financial statements of a private enterprise are not widely distributed and, accordingly, this Guideline has not been included in the proposed standards.

AcG-11, Enterprises in the development stage

147 The proposed standards do not include ACCOUNTING GUIDELINE AcG-11, Enterprises in the Development Stage. During the development of the proposed disclosure requirements, users noted that the existing disclosures in this Guideline are of little informational value to them. In respect of recognition and measurement issues it appears that GOODWILL AND INTANGIBLE ASSETS, Section 3064, covers what is required by AcG-11. As a result, the AcSB believes that this Guideline is largely redundant and, on that basis, has not included it in the proposed standards.

EFFECTIVE DATE

148 The proposed effective date of the proposed set of standards, for fiscal years beginning on or after January 1, 2011, is consistent with the date at which the existing Canadian GAAP will be superseded and publicly accountable enterprises will be required to adopt IFRSs. Early adoption of the proposed standards is permitted so private enterprises would have several years over which to make the transition.

TRANSITIONAL ISSUES

149 The AcSB understands that an enterprise adopting the proposed standards may have previously prepared its financial statements based on one of several different bases of accounting. Many enterprises will have previously prepared

financial statements in accordance with existing Canadian GAAP. However, the AcSB also expects that some enterprises that currently do not prepare GAAP financial statements will adopt these new standards. In the future, some private enterprises that previously reported using IFRSs will also adopt the Canadian GAAP for private enterprises. In each case, an enterprise will face a number of accounting policy changes.

- 150 ACCOUNTING CHANGES, Section 1506, generally requires retrospective application when new accounting policies are adopted. The AcSB decided that this should be the general principle for enterprises initially adopting the proposed set of standards for private enterprises, but recognized that for certain individual standards this might result in significant difficulties. For example, an enterprise may be unable to recreate the carrying amount of an asset or liability that originated several years ago and for which the enterprise's existing carrying amount is not consistent with the requirements of the proposed PROPERTY, PLANT AND EQUIPMENT, Section 3061. Similarly it might be difficult to restate a prior year business combination that was not accounted for in accordance with BUSINESS COMBINATIONS, Section 1582, or to determine the carrying amount in accordance with RELATED PARTY TRANSACTIONS, Section 3840, of an asset obtained through a related party transaction. The AcSB also noted that retrospectively applying certain requirements (for example, hedge accounting per FINANCIAL INSTRUMENTS, Section 3856), may lead to selective application to report a certain result or require the inappropriate use of hindsight.
- 151 Therefore, the AcSB developed, FIRST-TIME ADOPTION, Section 1500, to ensure that an enterprise's first financial statements prepared using the new standards for private enterprises contain high quality information that:
- (a) is transparent for users and comparable over all periods presented;
 - (b) provides a suitable starting point for accounting under Canadian GAAP for private enterprises; and
 - (c) can be generated at a cost that does not exceed the benefits to users.
- Section 1500 was based on International Financial Reporting Standard IFRS 1, "First-time Adoption of International Financial Reporting Standards."
- 152 The AcSB recognizes that the transitional issues facing individual enterprises will differ, depending on their previous basis of accounting and the nature of their business (amongst other factors), and that some enterprises will face only minor transitional issues. However the AcSB viewed the proposed standards as new GAAP for all first-time adopters and decided that all first-time adopters should be able to take advantage of the same transitional provisions. This means, for example, that an enterprise that has accounted for defined benefit pension plans on a basis consistent with EMPLOYEE FUTURE BENEFITS, Section 3461, would be able to use the transitional provision in Section 1500 to recognize all cumulative actuarial gains and losses at the date of transition to Canadian GAAP for private enterprises in the same way as an enterprise that had never previously applied Section 3461.

APPENDIX

ADDITIONAL BACKGROUND INFORMATION

Initial research

- A1 In developing the private enterprise strategy, the AcSB first undertook a comprehensive examination of the needs of external users of private enterprises' financial statements. This included meeting with a significant number of different types of users across the country and was completed at the end of 2006. While both internal and external users were consulted, the focus was on external users as, by definition, general purpose financial statements are designed to meet the needs of external users.¹ Internal users such as management of the enterprise have ready access to information and may wish to prepare internal financial reports in a way that meets their specific needs and circumstances.
- A2 The examination of the needs of financial statement users found no specific demand for a separate and distinct set of accounting standards for private enterprises. However, external users generally understood the problems being faced by private enterprises in the preparation of financial statements in accordance with current accounting standards, from both a cost and a complexity perspective. Many external users were familiar with differential reporting, as set out in DIFFERENTIAL REPORTING, Section 1300, and accepted the differential reporting model. Users in general were sympathetic to developing a set of accounting standards for private enterprises that required less effort and cost but still provided users with the information they need.
- A3 In May 2007, the AcSB published an [Invitation to Comment](#) (ITC) and accompanying [Discussion Paper](#) to solicit stakeholders' views as to the best approach for developing standards for private enterprises. The ITC and Discussion Paper included, among other things:
- (a) the results of the comprehensive review of user needs;
 - (b) tentative conclusions of the AcSB on a number of fundamental issues; and
 - (c) three possible approaches to developing private enterprise standards:
 - (i) an approach based on GAAP for publicly accountable enterprises (i.e., IFRSs) but providing for differences on a number of topics;
 - (ii) adoption of the proposed IFRS for SMEs² when finalized, possibly with some modification; and
 - (iii) an independently developed set of standards.
- A4 Late in 2007, The Canadian Institute of Chartered Accountants (the CICA, not the AcSB) issued for comment proposals for a Framework for Owner-managed Enterprises (FOME). The FOME was designed as a set of standards for enterprises that did not require GAAP financial statements because they did not have external users that relied on their financial statements. While the FOME was well received in terms of its content and overall approach, most constituents strongly believed that a "GAAP solution" was needed for private enterprises.

¹ See FINANCIAL STATEMENT CONCEPTS, paragraphs 1000.07-.14.

² The IASB expects to issue the final standard later in 2009.

Developing the proposals

- A5 The AcSB reviewed the comments on both its ITC and the FOME proposals early in 2008. Comments were received via written responses to both proposals, as well as through roundtable discussions held around the country. While the FOME was not produced by the AcSB, the significant feedback in response to it proved to be useful to the AcSB's deliberations.
- A6 The responses to the ITC were less supportive of the second approach, the IFRS for SMEs, than the other two options. Concerns were generally that it was currently under development and, therefore, unproven, and several technical aspects would be unacceptable in Canada.
- A7 The remaining options were each supported by approximately equal numbers of stakeholders. Support for the first option (IFRSs with differences) was generally related to the benefits of maintaining relatively close ties between private enterprise and public enterprise reporting, and the difficulties of understanding and maintaining two separate sets of standards, including the effects on the education system for accountants.
- A8 There was also considerable support for a set of standards based on existing Handbook standards but modified to meet the circumstances of private enterprises. Respondents noted that the FOME had demonstrated the benefits of this approach. They also noted that such an approach seemed likely to result in the timeliest development of standards for this sector. Many stakeholders commented that standards better suited to the private enterprise sector were needed in the short term.
- A9 After reviewing input from stakeholders, the AcSB decided to develop a set of "Made in Canada" accounting standards for private enterprises based on the approach outlined in paragraph 5.
- A10 The AcSB noted that the Handbook has existed for some time and to a great extent has met the needs of the private enterprise sector. Using the existing Handbook as a starting point would not require private enterprises and their accountants to undertake the significant change process with which publicly accountable enterprises are currently faced.
- A11 This approach was discussed at a number of roundtable meetings and other forums held across the country and was met with strong support from stakeholders. Constituents reiterated the message that a solution is needed in the short term, urging the AcSB to develop standards for private enterprises as soon as possible, while at the same time following appropriate due process.
- A12 Consistent with much of the feedback on the FOME, the AcSB decided that it was important that any standards it produced be general purpose and meet the needs of external users, (i.e., that they be GAAP for private enterprises). Standards could not be developed to meet the specific needs of a wide variety of special purposes that might exist amongst internal users. Further, internal users do not need standards as they have access to financial information and can determine how they want this information developed and reported (although they may choose to use GAAP for private enterprises).

A13 The AcSB considered whether the FOME could be used as a basis for developing private enterprise standards but determined that the different focus (i.e., internal users) would result in extensive work to modify the FOME and, accordingly, that using the existing Handbook as a basis would be more effective.

Advisory Committee

A14 To help in the development of the proposed standards the AcSB convened a special Advisory Committee. The committee is composed of members representing financial statement users, financial statement preparers, public practitioners and business advisors, and academe. Two AcSB members are members of the Committee.

A15 The Advisory Committee met a number of times throughout the summer and fall of 2008 and also early in 2009 to develop its recommendations to the AcSB. Working drafts of the proposed standards, as developed by the Advisory Committee, were posted to the AcSB website to provide information on the direction of the proposed standards and to provide the opportunity for input by stakeholders.