



Certified General
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Comptables généraux
accrédités

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Mr. Peter Martin, CA
Director, Accounting Standards
Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2

Dear Mr. Martin:

Re: Accounting Standards in Canada: Future Directions

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the future direction of accounting standards in Canada. As a leading accounting association representing the interests of 62,000 members and students nationally and internationally, CGA-Canada believes it has a responsibility and duty to actively participate in discussions about the choice of accounting standards in Canada.

The development of accounting standards is also a matter of public interest. Standards play an important role in shaping public confidence and influencing the economy. We appreciate the opportunity to participate in the ongoing dialogue afforded by the Accounting Standards Oversight Council (AcSOC) and the AcSB.

CGA-Canada's commitment to standard setting is evident in its numerous published papers and responses to exposure drafts issued by standard-setters like the AcSB, the International Accounting Standards Board (IASB) and the International Federation of Accountants (IFAC).

The AcSB will also be familiar with CGA-Canada's most recent reports, which explore key issues surrounding the shift towards a global set of accounting standards and the standard setting process in Canada and abroad.

CGA-Canada has consistently identified a number of fundamental principles the Association believes should guide standards setting in Canada. These include that:

- Accounting standards are a matter of public interest. All those affected by financial information should participate in the standard setting process. This includes governments, regulatory agencies, and preparers and users of financial information;
- In the pursuit of a framework that promotes high quality, reliable financial information, standard setting should rely on expert knowledge, experience and rational and aim to maximize accuracy, transparency and simplicity in financial reporting;

- Standard setting should be based on structures and processes that demonstrate unwavering commitment to openness, fairness and impartiality;
- The accounting profession must continue to play a role in standard setting. However, for the public interest to be served, that process must be independent and at arm's length from the profession.

These principles form the basis of our comments regarding the future of accounting standards for Canada.

Summary of CGA-Canada's Views:

1. CGA-Canada supports the adoption of International Financial Reporting Standards (IFRS) for Canadian entities.
2. To facilitate the adoption of IFRS in Canada, CGA-Canada proposes that the Canadian standard-setter^{*}:
 - Adopt IFRS for all publicly accountable entities;
 - Adapt the standards to suit the Canadian regulatory environment to the extent required by Canadian law or regulation;
 - Develop and improve on Canadian standards for differential reporting with the aim to harmonize with, and eventually adopt, appropriate and responsive international standards for small and medium-sized entities (SMEs) as they materialize; and
 - Actively participate in the development of international accounting standards with the IASB, paying particular attention to the needs and reporting constructs of SMEs.
3. With respect to the accountability and oversight of the standard setting process, CGA-Canada believes legislative changes must be made to ensure that those who set Canadian accounting standards operate independently and at arm's length from all professional accounting bodies. Standard setting should be performed openly by way of public meetings and strengthened through the practice of publicly availing submissions to the standard-setter.

ADOPTING INTERNATIONAL FINANCIAL REPORTING STANDARDS

Need for a Common Standard

CGA-Canada believes that users of financial statements are best served by a common set of global accounting standards. It no longer makes sense for national standard-setters to develop and maintain a unique set of standards in an increasingly global marketplace where users and preparers of financial information need to rely on comparable financial information.

As capital flows freely across borders, so should the financial information on which investment and lending decisions are made. We can expect that migration to internationally adopted standards should have a positive impact on the aggregate cost of capital in all participating markets.

The Standing Senate Committee on Banking, Trade and Commerce agrees with the move to a common global accounting standard. In its June 2003 report, it recommends that the "federal government take a leadership role and work with Canadian stakeholders in undertaking

* At the present time, the authority to set standards in Canada is delegated to the Canadian Institute of Chartered Accountants through regulations of the *Canada Business Corporations Act*.

discussions with the U.S. Financial Accounting Standards Board and others that will result in all relevant parties working expeditiously toward the development of global uniform accounting standards.”

The resources required to develop unique national standards in an increasingly complex global environment are beyond the capacity of many countries. Standard setting has become burdensome and inefficient. Domestic standard-setters are increasingly pressured to ensure the development of high quality standards at a fast pace, yet with limited resources. As access to money, talent and people becomes more constricted, the challenges will also become more acute.

Adopt IFRS

As the IASB’s capacity and legitimacy has strengthened, so too has the world’s interest in IFRS. We are at a crossroads, which now affords us the opportunity to remedy or at least relax the stresses on the current Canadian infrastructure and we should embrace the opportunity.

While there have been significant growing pains, adoption of IFRS has become relatively popular in dealing with the aforementioned constraints and inefficiencies. In fact, the IASB in its 2003 annual report declared that from January 1, 2005 more than ninety (90) countries on six (6) continents will either require or permit the use of IFRS. Twenty five (25) of those countries are constituted by the European Union while other prominent countries include Australia and New Zealand.

Prompted by the Norwalk Agreement entered into by FASB and the IASB on September 18, 2002, the IASB and FASB have embarked on an ambitious program aimed at converging US GAAP with IFRS. Several changes to US GAAP have already been proposed to bring US standards into line with international practice. Additionally, the IASB has recommended revisions to IFRS to more closely align with US GAAP.

In 1999, the CGA-Canada Board of Directors agreed that Canada should adopt international accounting standards as developed by the IASB for financial reporting in Canada.

CGA-Canada commends the AcSB for the foresight of its current strategy to minimize GAAP differences with the US, while forging ahead in its contributions to the development of high quality international accounting standards. This strategy has served to position Canadian issuers and companies of all sizes for the adoption of either IFRS or US GAAP. While the approach might have been appropriate when adopted, we believe the environment has matured sufficiently to allow a shift in strategy moving forward. We believe the AcSB must shift focus towards acceptance of IFRS for Canada.

It is widely acknowledged that IFRS have gained wide acceptance as a credible alternative to US GAAP. The AcSB acknowledges the IASB has made “considerable progress in establishing itself as one of the world’s two pre-eminent accounting standards setters.” Given the vast improvement in the quality of IASB’s standards in recent years, and given the growing acceptance of IFRS worldwide, Canada would be best served by adopting IFRS. The principles-based approach of the IASB is recognized as being more coherent with the current approach of the AcSB. Increasing cooperation between domestic and international standard-setters and alignment of agendas and work plans will play a helpful role in the transition.

Given limited resources and complexity of the environment and as a matter of efficiency, CGA-Canada recommends that the AcSB lessen its efforts to harmonize with US GAAP where it interferes with a commitment to IFRS or is outside of a global harmonization context. Given that

Canadian resident SEC registrants are permitted to use US GAAP, US and International GAAP are converging, and Canadian standard-setters have a positive influence on IFRS, Canada is well served to commit its energies and resources to the international stage.

IFRS vs. US GAAP

CGA-Canada does not believe that US GAAP is appropriate for the Canadian environment. There are a number of factors in the US that lead us to this conclusion, including the (i) lack of independent funding for FASB, (ii) difficulty of Canada's standard-setter influencing US accounting standards, (iii) complexity of US standards, (iv) rules-based nature of US standards, (v) focus of US GAAP on reporting issuers, and (vi) possibility of political interference in the US standards setting process.

There have been a number of reforms which have occurred at FASB since the adoption of the *Sarbanes-Oxley Act, 2002* by the US Congress. In particular, funding for FASB now comes from public companies, whereas previously, it was funded by multiple sources. CGA-Canada believes a standards-setting process funded from multiple sources produces outcomes less apt to fall to the influence of a single party.

With respect to influencing the development of international standards, Canada is more likely to have greater influence in shaping IFRS than US GAAP. With the small size of the Canadian marketplace relative to the US, the ability of Canada's standard-setter to influence the development of US accounting standards is limited. Although Canada is still a small player internationally, it is felt that with relative early adoption of IFRS, and with its reputation for technical expertise in standard setting, Canada's standard-setter will have a greater influence over international standards than it may have influencing FASB and US accounting standards.

It is felt that the complexity and sheer volume created by the comprehensive accounting literature in the US, has resulted in "standards overload" for a number of companies complying with US GAAP. A majority of Canadian companies currently do not have the internal expertise, resources or capacity to master the application of US GAAP. The gap in expertise that was once filled by the assistance and advice of external auditors is now limited as a result of recent changes to auditor independence rules in Canada. CGA-Canada is concerned that as a result of this change, the marketplace may choose a less rigorous method of preparing financial information. There is already a perceptible trend that when not required by law or regulation, corporations are choosing to depart from GAAP requirements. While we are not suggesting "lightening the accountability load," we are proposing the adoption of a set of *appropriate* standards — standards that will allow a high degree of compliance. Arguably, the result will be the availability of credible, comparable financial information.

In addition to their complexity, US standards are considered to be more rules-based and prescriptive in nature. This approach to standards setting has been considered by some to have contributed to the accounting scandals experienced in recent years. Although CGA-Canada recognizes that most international standards are a combination of rules and principles, it is felt that with a more rules-based approach such as what exists in the US, companies become more focused on a threshold value provided by the rules rather the spirit of the rules themselves.

The rules-based approach of FASB is also a factor when considering a transition to either US GAAP or international accounting standards. Since Canadian standards are considered more principles-based (similar to those of the IASB), a transition to US accounting standards would be more costly than a transition to IFRS. This point is supported by Erin Webster and Dan Thornton in their paper titled "Earnings Quality under Rules- vs. Principles-Based Accounting Standards:

A Test of the Skinner Hypothesis” where they argue that as a result of a rules-based system, the US has an extensive oversight capacity in order to compensate for the rules. Moving to a more rules-based system would not only represent a change in approach, but would also require significant resources to develop the oversight mechanism needed to enforce more rules-based standards.

US GAAP applies only to reporting issuers, which is a concern as Canada’s economy and growth is largely dependent on small and medium-sized entities. Users’ needs for financial statements are different for SMEs. As a result, Canada requires standards that meet the needs of both the publicly accountable entities and SMEs. Given the recent initiative by the IASB to develop international standards for SMEs, and FASB’s sole focus on reporting issuers, Canada is better served by adopting the IASB’s international accounting standards and not US GAAP.

Finally, the choice of IFRS over US GAAP is supported by the view that the accounting standards setting process in the US is more susceptible to political interference. This point is illustrated by the current disagreement in the US with respect to the treatment of stock-based compensation, particularly options.

INTERNATIONAL FINANCIAL REPORTING STANDARDS FOR CANADA

“Publicly Accountable” Entities a First Step

While CGA-Canada believes that the development of a single set of global accounting standards is important to allow for comparison between entities, the association recognizes it may be challenging over the short term to develop a single set of standards that meets the needs of *all* entities. Therefore, the association recommends that as a first step toward international accounting standards for Canada, the standard-setter adopt IFRS for all publicly accountable entities by January 1, 2008. A publicly accountable entity is defined by the IASB¹ as an entity that has “a substantial group of persons outside the entity who have a direct financial interest in or claim against the entity or who are dependent on the entity to provide essential public services. These persons have a legitimate need for financial information about the entity but lack the power to demand the information for themselves.” We do not believe that a differentiation should be made for small reporting issuers. All entities seeking capital on the equity markets should be subject to the same robust rules if they are to fairly and responsibly compete for capital.

Financial statements must be prepared with the users of those statements in mind. At the present time, it is generally acknowledged that the focus of current IFRS is considered by many to be primarily on publicly-listed entities. This view is supported by the IASB in its discussion paper on accounting standards for SMEs when it states that “at least in those developed countries in which IFRSs are used either by regulation or at the option of the entity, the primary adopters are entities whose securities are publicly traded.” Yet it is understood that as IFRS mature as more and more jurisdictions adopt and implement IFRS, the scope of standards will extend and become more appropriate for use by privately-held and not-for-profit entities.

Privately-held and not-for-profit entities are typically not involved in international capital markets, and as such, a plausible argument is oftentimes made that it is unnecessary to meet the requirements of global standards when the resulting financial information goes beyond the perceived needs of the users of their financial statements. Further, these smaller entities may lack the expertise and resources required to comply with standards developed for larger, multinational organizations.

¹ *Preliminary views on Accounting Standards for Small and Medium-sized Entities*

Based on these arguments, CGA-Canada recommends that Canada adopt IFRS for “publicly traded” and “publicly accountable” entities by January 1, 2008, by which time Canada will be able to benefit from the experience of Australia and the European Union.

Transition to IFRS

It is anticipated that there will be some transitional issues associated with adopting IFRS. Time will be required to review and modify the language of IFRS to accommodate the Canadian legislative and regulatory environment. Preparers and users will also need time to familiarize themselves with and adapt to the new standards. CGA-Canada recommends the establishment of a transition period for full adoption of IFRS. Our recommendations are:

- Replace all existing Canadian standards with the associated international standard by January 1, 2008;
- In adopting standards, only modify the language of the standards to accommodate the Canadian legislative and regulatory environment;
- Until complete transition to IFRS on January 1, 2008, adopt new IFRS as they are issued and amend existing standards to eliminate insignificant or redundant differences;
- Monitor the progress of IFRS implementation in Australia, New Zealand, and the European Union in order to anticipate and understand potential problems and capitalize on unforeseen opportunities;
- Provide guidance to Canadian preparers in those circumstances where the IFRS are silent (i.e. changes to regulations or laws in Canada with financial implications that are not covered by IFRS) in the form most appropriate to the circumstances; and,
- During the transition period and afterwards, continue to direct focus and energy to support, strengthen and promote the IASB initiative.

With the continued convergence of Canadian standards with IFRS over the transition period, and with a review of the challenges encountered in other IFRS adopting nations, Canada should be well prepared for full adoption of IFRS by January 1, 2008.

Differential Reporting and Standards for SMEs

User needs with respect to stewardship and decision-making of smaller entities is different from that of other reporting entities. Currently, many SMEs view the information provided by GAAP as unnecessary and of limited value when compared to the cost of providing that information. CGA-Canada supports the continued development of separate standards for SMEs.

Consistent with many nations, differential reporting is important in Canada given that a majority of companies fall into the small or medium-sized category. This has resulted in the establishment of separate standards for smaller entities throughout the world. Australia, New Zealand, Hong Kong, the UK, and even the US with its “other comprehensive basis of accounting,” have separate standards for smaller or non-public entities.

With the development of a stronger set of international accounting standards, the emergence of standards to serve the specific needs of the SME sector has lagged despite support by most of the world’s national accounting standards-setters. The association supports the IASB’s initiative to explore and develop SME GAAP. SME GAAP would represent not an inferior quality of GAAP, but one which is responsive to the needs and characteristics of non-public entities and which is respectful of the needs of the users of the financial information.

As indicated earlier, CGA-Canada supports the development by the IASB of a set of international accounting standards for SMEs. This has been the approach adopted in Canada by the AcSB. Although more research into the effectiveness of differential reporting is needed, anecdotal evidence suggests that it has been well received and that the current qualifying factors are appropriate. CGA-Canada contends that rules based on criteria such as size tests result in poor application of standards, as entities, instead of concentrating on meeting the spirit of the standard, will have a proclivity to focus on being on one side or the other of the size test depending on some desirable outcome.

Transition to International SME Standards

As there are currently no international standards related to SMEs, CGA-Canada recommends that the Canadian standard-setter continue to develop and improve Canadian standards for differential reporting with the view of harmonizing with and eventually adopting international standards for SMEs of the International Accounting Standards Board as they evolve. Until such time as international standards for SMEs exist, and given Canada's advanced standing in SME accounting and reporting, Canada's standard-setter should continue to actively contribute its expertise to the IASB while setting domestic standards for SMEs.

Role for Canada's Standard-Setter

As Canada adopts IFRS, the role for domestic standard setting should lessen. Canada is recognized as being rich in the very specialized and highly technical expertise of its standard-setter. That expertise has come to play an influential role in the development of international accounting standards and a significant role in the convergence of national standards. As we move forward in the adoption of IFRS, we should not lose that capacity or the reputation which has been earned. There continues to be a role for a standard-setter in Canada. In fact, a commitment to adopting IFRS should further strengthen Canada's ability to influence the development of international standards.

Adoption of IFRS by Canada would free up resources previously used to both develop unique Canadian standards and work with the IASB and FASB. As a result, additional resources could be applied to the provision of training and guidance to preparers, users and accountants to ease the transition towards IFRS.

The standard-setter will be required to actively monitor the implementation of IFRS in other jurisdictions to prepare for the acceptance and implementation in Canada.

NEED FOR ARM'S-LENGTH STANDARDS-SETTER

Canada continues to be the only industrialized nation in the world that relies on a private accounting organization to set accounting standards.

It continues to be CGA-Canada's position that the status quo is not acceptable. As Canada moves towards acceptance of IFRS a review of the structure and processes of standard-setting should also be undertaken. A framework should be introduced in which standards development and processes are addressed simultaneously.

In today's complex economy, the development of accounting standards cannot be permitted to remain the sole domain of a single homogenous group of professionals; let alone a single body from within the entire profession. CGA-Canada proposes the establishment of an independent Canadian Accounting Standards Committee (similar to those in the U.K. and Australia) to oversee the alignment and implementation of international standards in Canada.

We believe that a reformed Canadian standard-setter should:

- Be independent of all parties who have an active interest in the content of accounting standards;
- Be mandated by legislation with defined objectives and mandates;
- Be accountable to the public by reporting to a duly appointed oversight body which is ultimately accountable to the federal Minister of Finance;
- Be funded from multiple sources including government, industry and the accounting profession;
- Have transparent process in which all meetings are open to the public and documents prepared by or submitted to the standard-setter are publicly available.

CONCLUSION

We appreciate the opportunity to provide comment to this very essential and valid process. We look forward to further discussions on moving forward with those organizations — both public and private — that have a stake in the success of financial reporting reform for Canada.

Sincerely,

Original signed by:

Tony Ariganello, BComm, FCGA
President and Chief Executive Officer