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Peter Martin
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Accounting Standards Board
277 Wellington Street West
Toronto, Ontario M5V 3H2

By Email: ed.accounting@cica.ca

Re: Invitation to Comment - Financial Reporting by Private Enterprises

Dear Peter,

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Accounting Standards Board's Discussion Paper on Financial Reporting by Private Enterprises. CGA-Canada is a leading accounting organization with 68,000 members and students in Canada and internationally. Any proposals leading to development of new or amendments of existing standards are of considerable interest to all our members.

In the spirit of informing our response, several roundtable meetings were held with CGAs in November 2006 and July 2007. In those meetings, the members discussed the merits of adopting IFRS for SMEs or continuing to use the Differential Reporting as practised in Canada. This response includes the results of those meetings in addition to subsequent research and analyses by CGA-Canada.

We will preface our discussion with an overall general comment and general remarks, and then proceed to provide direct comments to three specific options (***bold italics***) identified by the Board, provide a summary of comments, and lastly, present our conclusion.

Overall General Comment

Our members have told us that the IFRS for SMEs is a viable product. They consider the IFRS for SMEs Exposure Draft to be an excellent document; it provides substantial

information; it is well organized, well indexed, and in it most terms are well defined. All things taken together, the IFRS for SMEs is simpler than full IFRS – a necessary condition if it is to be embraced by private companies.

General Remarks

We do, however, have five general remarks:

1. General Purpose Financial Statements (GPFS)

The general-purpose financial statements must exhibit characteristics including those of relevance, clarity, accuracy, comprehension, and completeness. The statements must provide decision-useful information needed by all types of users, e.g. equity investors, rating agencies, lenders/creditors, suppliers of risk capital (e.g. venture capital), debt and equity investors' advisors, and other stakeholders such as existing or prospective customers and suppliers, and employees as shareholders, senior employees or other employees. The statements specifically prepared for a regulatory agency such as the Canada Revenue Agency (CRA) would not be a GPFS.

The major difference between a publicly accountable and a private company (non-publicly accountable entity) is the number of shareholders and whether those shares are traded freely on a stock exchange. Naturally also, publicly accountable entities are subject to debt rating and more extensive investment analysis. Understandably though, there is academic and practical attraction to nevertheless maintain a high level of accountability within the statements and in pursuing the desirable characteristics earlier identified. For example, in a private company or in a small publicly accountable entity, a prospective employee or supplier could typically base business decisions on the entities' financial ability and disclosure.

Generally, the concept of "significant external users"¹ is advanced. On the premise that there are no significant external users, the statements are oftentimes permitted to have a lesser amount of accountability and will typically fail to satisfy sought or desirable characteristics. Many argue that 80 per cent of private companies prepare reports for owners/managers, bankers, and tax authorities and those owners/managers provide personal guarantees for loans. Many contend therefore that such entities should not be required to prepare GPFS. Our reservation is that this argument does not give due accountability and consideration to other prospective stakeholders including successors and parties to contractual assignments. We concede that other stakeholders, as referred to above, are

¹ In Appendix D, Paragraph D5 of the Discussion Paper defines significant users as, "*those users to whom you [as the company owner or CFO] feel an obligation to provide your company's financial statements because of the importance of their decision-making needs.*"

typically not defined as external users but assert that this may not be an optimal state; perhaps even short-sighted given that these entities evolve, mature and transform over a life time and could benefit from increased access to, and veracity of, financial information.

Some argue that the financial statements of private companies are prepared for lenders and not for investors. We believe that GPFS are prepared for all stakeholders including minority shareholders and prospective venture collaborators.

Not-for-profit companies, although in general not recipients of public contributions per se, are required to produce general-purpose financial statements. We believe that IFRS for SMEs are a reasonable option. We believe also that IFRS for SMEs afford charities, which do receive contributions from public, a reasonable reporting regime.

2. Evolving from a small to large private company or to a small/large listed company

Generally, most private companies start as small/micro entities. While owners are relatively modest, many silently hope to someday render their entity a larger, even listed entity. Depending on managerial capacity and the business plan, an entity may remain a small entity for a long time or in some cases never become a large private company or a listed company. The owners of such entities, if asked, are likely to respond that they don't wish to become a large or a listed company, but these individuals are entrepreneurial and will oftentimes harbour aspirations which are inconsistent with the public modesty which they exhibit.

As humans exhibit such hope, a case may be made that they should prepare GPFS and follow IFRS for SMEs. It is beneficial for some of the reasons cited above but serves also to facilitate migration to full IFRS as the entity transforms and evolves. And even when an owner is not attracted to such growth, such companies may someday encounter a competitor which is a listed company or uses IFRS for SMEs. Therefore, for such a company, even to analyse the financial statements of the competitor, the knowledge of the IFRS for SMEs is beneficial. If so, then why might we assume that owner-managers are uninterested to prepare their own statements using IFRS for SMEs?

Also, our research revealed that the smaller companies listed on the Toronto Stock Exchange have market capitalization of less than \$5 million and a total asset base of less than \$6 million. Conversely, one of the largest non-listed private companies in Canada has total sales of \$6.3 billion, total assets of \$3.1 billion, and an employee count of 29,000 strong. Are we to conclude that this non-listed private company has less public accountability and needs simpler accounting-standards than the smaller listed company?

It can be argued that on a cost/benefit basis, micro-entities should not be required to prepare GPFS. The European Union defines a micro entity as one which has less than 10 employees and less than \$3 million assets². Our research determined that the TSX (Toronto) Venture Exchange in Canada posts several listed companies having assets of less than \$400,000. Clearly, they are micro-listed companies. If micro-listed companies are required to produce GPFS, it is reasonable that micro-unlisted (private) companies of perhaps greater magnitude should be. Or do we now mean micro-micro companies (entities)? Admittedly, these arguments can all become circular but we are reasonably confident that the case for IFRS for SMEs has been made and that it can apply across a vast spectrum.

The Discussion Paper in Paragraph # 55 asks, “*whether private enterprise standards should in some way be linked to IFRS*”.

We believe it certainly should be linked and we agree with your list of advantages enunciated in your Paragraph # 56 such as “*many private enterprises have international transactions and connections; consequently, some degree of compatibility with IFRS would be desirable; preparers, users, auditors and others would have to become familiar with only one basic system rather than two; education and training costs would be less with just one system; it would minimize differences between standards applied by publicly accountable enterprises and those by private enterprises;*” etc.

The domestically developed standards for private companies that are unlinked with the IFRS will cost, time and effort to the Canadian market place in staying up to date with two separate sets of standards and also add to the standards overload not only to the owners and preparers of the financial statements but also to the users and other stakeholders.

Paragraph # 57 states, “*Comparability with enterprises in other countries, with the possible exception of the United States, may not matter to **many** Canadian private companies.*” [Emphasis added.] As noted already, the DP in Paragraph # 56 also states, “***Many** private enterprises have international transactions and connections; consequently, some degree of comparability with IFRS would be desirable*”. [Emphasis added.]

In short, the Paragraphs # 56 and # 57, with respect to the Canadian private enterprises, says that one set of “many” would want international standards for comparability purposes, another set of “many” would want U.S. developed standards for comparability purposes (if that comes to passing as mentioned in Paragraph # 60 discussed under Option # 1), and the remaining “many” would want nothing to do with the international or U.S. standards because they presently don’t have a need for comparability; they might want Canadian

² “Tackling Compliance: Small Business and Regulation in Canada”, 2006, Rock Lefebvre and Phil Gans, Certified General Accountants Association of Canada; accessible on CGA website.

standards. What the DP doesn't address is out of the last group of "many", if they encounter an international competitor, what would they do? The DP implies that under such a circumstance the private company should unlearn Canada based private company standards and should relearn the competitor's jurisdiction standards and incur additional costs to convert its own financial statements to competitor's jurisdiction's standards. In so doing, it would cause unnecessary grief to the private company just because it made the wrong decision to apply the Canada developed standards for private companies in the first place.

The Paragraph # 57 also states, "*Although some of the arguments against linkage might not stand up under an approach that modifies IFRS or the proposed IFRS-SME to suit Canadian circumstances, they may not be overcome completely.*"

This comment is discussed under Option # 2.

3. Stand alone document

The CGA program of studies is continually updated with latest concepts, ideas and theories related to accounting and assurance and practitioners' practices and standards. We expect to have completely integrated the introduction of full IFRS into the curriculum by the time the Canadian Accounting Standards Board (AcSB) moves from domestic to full IFRS in 2011. By this date, our new members will be knowledgeable of the full IFRS. Through our emphasis on mandatory Continuing Professional Development (CPD), we anticipate that our current members would also be fully conversant with the full IFRS.

Since the IFRS for SMEs is a derivative of the full IFRS requiring only the simpler options from the full IFRS; we don't foresee insurmountable challenges to our members becoming fully proficient in the esoteric of the IFRS for SMEs. We envisage our members, while applying the IFRS for SMEs, will encounter situations where the answer is found only in the full IFRS and expect that members will become increasingly versed, through training and practice, in the full IFRS.

Thus, if the IFRS for SMEs is not a completely stand-alone product, this will be mitigated by the fact that a Canadian accountant will be concurrently and increasingly knowledgeable/ experienced in the full IFRS as well.

During our roundtable discussion meetings, some wished to have a stand-alone complete document but they were also cognizant of the fact that the document would become bulky. Therefore, they suggested that the standards applicable to infrequent transactions should be included in the appendix for such reasons as disinterest in having something like IAS 39 included completely in the IFRS for SMEs. Some private companies may never need to refer to such a standard.

On the other hand, some felt that cross-referencing makes sense because if an entity encounters a transaction that it normally would not enter into; it can refer to the full IFRS for guidance. What that means is that the accountant would need to purchase both the full IFRS and the IFRS for SMEs.

If the IFRS for SMEs, as a stand-alone product, is perceived to be expensive, then the users (buyers) of the product should reasonably expect it be completely stand-alone with no cross-references to the full IFRS. In the end, this issue appears to be more of a cost and convenience issue than one of knowledge or substance.

Thus, we believe that in an age of electronics, both standards can be fully linked electronically and the information can be made readily available. In the current world of technology and communications, the number of pages becomes much less relevant. Recognizing that all nations do not benefit equally from advances in telecommunications, some countries will of course be disadvantaged and will prefer printed versions. Here again, the cost to purchase the standards will likely constitute the major issue.

We would recommend that the AcSB lobby and suggest to the IASB to price access to its standards by taking into consideration the means of an accountant providing services in some remote part of a lesser-developed country. We would recommend also that electronic medium pricing be incremental regardless of the publishing option elected by the IASB.

During our discussions, some participants expressed that a two-year frequency would be welcome relief from the current practice in Canada. Some members believed that a regular release every two year period could be followed by a big announcement to draw attention to the need for accountants to take heed.

Others expressed that the amendments to IFRS for SMEs should be made as and when a change is made to full IFRS. Otherwise the IFRS for SMEs would not stay in-step with the full IFRS.

On balance, CGA-Canada supports a decision to publish IFRS for SMEs approximately every other year.

We would however propose that the IASB consider publishing IFRS for SMEs, in the beginning, on an annual update basis for say, the first three years. Thereafter, when issues have stabilised, issuance on a two-year basis is expected to be adequate.

4. Changing role of domestic standards setter to domestic gatekeeper

The use of professional judgement and the development and enforcement of standards and the presentation of information in financial statements that would

satisfy all stakeholders require a balancing act, i.e., balancing the needs of managers, equity investors, creditors, suppliers of risk capital, debt and equity investors' advisors, employees as share holders where applicable, senior employees, financial analysts, rating agencies, regulatory bodies and other users of financial information.

If all countries' had their own standards-setters develop standards that would satisfy the needs of all stakeholders while attempting to achieve balance in continuum, the price of standards development and maintenance including other infrastructure costs would become exorbitant. It doesn't make economic sense.

Thus convergence of standards to the IASB makes financial and business sense. This also makes sense even for the private company standards, i.e., IFRS for SMEs.

Such an approach should, at least theoretically, represent a more comprehensive and effective deployment of talent and resources. One, which pronounces on optimum benchmark.

The International Accounting Standards Board tries to find balance. It is an independent, private-sector body that develops and approves International Financial Reporting Standards (IFRS) for all stakeholders in the global village. Also, the IASB's due process is not subjective because the IFRS for SMEs would be put to the rigours of Field Testing before becoming a standard.

Knowing that the IASB's due process and diligence is rigorous, the domestic standards setter should feel good about that the standards developed by the IASB are of high quality.

The Discussion Paper raised concerns about the role of the domestic standards setter in Paragraphs # 57 that, "*Canadian standard setters would lose control over accounting standard setting, at least to some degree. While this may be justifiable for publicly accountable enterprises because they deal with global capital markets, this is not necessarily the case for private enterprises.*"

This concern is unwarranted, as every jurisdiction would continue to need an **independent** domestic gatekeeper to ensure the IASB standards do not violate any national laws.

The Canadian standards setter should collaborate with the IASB in researching accounting issues of importance and leverage its expertise developed over the years in helping the IASB develop quality standards.

5. Hierarchy, i.e., General referral to full IFRS

We agree with the requirements of paragraphs 10.2 – 10.4 of the IASB’s IFRS for SMEs, coupled with the explicit cross-references to particular IFRS in specific circumstances.

In our consultations, participants discussed some debt instrument/conditions such as puttable shares, subordinated debt, convertible debt, retractable debt, etc. The general agreement was that a typical private company would not encounter such transactions, however, if one does encounter such instruments; they should be free to follow the provisions of paragraph 10.2 – 10.4, coupled with the explicit cross-references to particular IFRS in specific circumstances.

Nevertheless, we discussed whether the discussion on functional currency is warranted given that the perceived profile of the typical private company operating in a particular jurisdiction would be the subject only of domestic operations. That said, there may be a significant number of private companies that may have operations in other jurisdictions and for those private companies, the discussion may well be warranted should the numbers justify.

On balance, we feel that this topic should be left for reference to the full IFRS; i.e. should a private company have foreign operations, it should refer to full IFRS.

Option 1 — A top-down approach based on GAAP for publicly accountable enterprises

This option involves modifying GAAP for publicly accountable enterprises (IFRS) by deleting some requirements or embedding different treatments in the standards, much as done in Canada’s current “differential reporting” model. This option may provide the strongest linkage to IFRS, depending on the number of differences adopted.

Readers are asked to assess this approach with an open mind, setting aside their opinion of the current Canadian differential reporting model and without focusing on any specific modifications to IFRS that might be required for private enterprises. With this approach, all aspects of the current differential model would be open for debate. Certainly, a differential approach based on IFRS could differ from the current differential reporting model quite significantly in its specific features. Respondents are asked to comment on whether the “mix and match” aspect of the current differential reporting model should be retained under this option, or replaced by an “all or nothing” basis of application.

Paragraphs 59-66 of the Discussion Paper discuss this option further, including the AcSB’s assessment of its advantages and disadvantages.

The Discussion Paper has raised two questions:

The first question is: Would Option # 1, i.e., Differential Reporting proposed to be developed by the AcSB that is based on full IFRS provide a superior product than the Option # 2 which is a sort of Differential Reporting developed by the IASB, i.e., IFRS for SMEs?

The second question is: If the AcSB were to develop Differential Reporting standards based on full IFRS, what type of Differential Reporting is preferable, “mix-and-match” or “all-or-nothing”?

High-level comments to various paragraphs in this part of the Discussion Paper are provided below first before addressing these questions.

Paragraph # 60 states, *“The US Financial Accounting Standards Board (FASB) recently set up a committee to make recommendations on whether there should be differences in accounting standards for private enterprises. It appears that this committee is contemplating a top-down or differential approach.”*

To our knowledge, no definitive report has been advanced to date by the Committee that says what the FASB favours or has decided to proceed with the development of a sort of differential reporting based on the full IFRS. Should the Committee decide in favour of differential reporting then why would Canada wish to develop its own differential reporting standards and put the Canadian market place at a disadvantage and be on the offside with the market of Canada’s largest trading partner? Under those circumstances we would favour adoption of differential reporting standards developed by the U.S. and urge the Canadian Accounting Standards Board to work with the U.S. FASB and jointly develop one differential reporting model. However, under this approach, the private company standards would not address the treatment of, what the DP has mentioned many times but has not identified, unique Canadian specific transactions.

It should be noted that the Invitation to Comment on “Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies” – A Joint Proposal by the U.S. FASB and the American Institute of Certified Public Accountants (AICPA) – dated August 15, 2006, in Paragraph # 17 states, *“The FASB and the AICPA are jointly proposing changes to improve and encourage greater input from private company constituents. These changes will assist the Board in determining whether differences should exist within the existing framework of financial accounting and reporting standards of private companies. The objective of the change is not to create a separate, new set of GAAP requirements for private companies.”*

Also, please note that the AICPA, in response to the IASB's IFRS for SMEs Exposure Draft - dated October 15, 2007, with respect to the Private Company Financial Reporting Committee initiative in the United States, states, "*We understand that the Committee is focusing on the IASB's work in this area and is very interested in the IASB's further deliberations toward a final SME standard.*" The response further states, "*The Committee is studying a number of topics that have been identified by the SME exposure draft and is embarking on a major outreach to key constituents of private company financial reporting in the U.S. to assess user needs and costs related to each of those topics.*"

Consequently, we believe, the Committee is still evaluating the user needs and the IFRS for SMEs and has not yet decided whether it favours top-down or differential reporting.

In Paragraph # 61, the DP states, "*A differential approach based on IFRS could differ from the current differential reporting model quite significantly in its specific features.*"

During our roundtable discussion meetings our members told us that they do not favour the present model of differential reporting. Why would Canada adopt such an approach and put the Canadian enterprises at cost disadvantage because the approach would definitely be different from the IFRS for SMEs which is expected to be widely adopted in the world where due to globalization, the Canadian private companies have to compete for the cost of capital and market share. Some might say that the Canadian private companies raise funds only in Canada but they do not give due consideration that the Canadian banks have global operations and like any financial institution in the world they look to maximize return and they would not lend to a private company just because it is either located or operating in Canada. Only when all things being equal and keeping in mind the risk and rewards, a Canadian financial institution would prefer to lend to a Canadian private company.

We agree with Paragraph # 62 that many "*private enterprises have international transactions and connections; consequently, some degree of compatibility with IFRS would be desirable*".

Paragraph # 63 states, "*Current IFRS may cover topics or options that are not relevant to many private enterprise constituents. IFRS also have to cover issues relevant to other countries that are not necessarily relevant to Canada.*"

The DP does not identify here what types of transactions or issues would not be relevant to Canada. We wish to note here, generally, there are same types of stakeholders of private companies as are for publicly accountable enterprises and that a financial transaction that is applicable to a private company would also be applicable to a listed company and vice versa.

Paragraph # 63 also states, "*Canadian accounting standard setters would lose control over standard-setting decisions, at least to a large degree.*"

Please see our General Remark # 4 for discussion on “Changing role of domestic standards setter to domestic gatekeeper”.

Paragraph # 63 further states, *“While this may be justifiable for publicly accountable enterprises because they operate in the global capital markets, this is not necessarily the case for private enterprises.”*

Please see our discussion related to paragraphs # 56 and # 57 under General Remark # 2 “Evolving from a small to large private company or to a small/large listed company” and our comments on Paragraph # 62 above.

Paragraph # 64 seeks views on *“whether each differential treatment should be elected individually, as is the presently the case under Section 1300”, i.e., “mix-and-match” or “whether an enterprise should apply all of the differential treatments available (“all-or-nothing”)*”.

We must confess we are at a loss to conceptualize “nothing” part of the “all-or-nothing”. We understand “all” that is a subset of “mix-and-match” scenario but can’t fathom “nothing”. Does that mean no Differential Reporting? Does that imply that under those circumstances all Canadian private companies should follow full IFRS?

Presented next are comments on *“non-consolidated financial statements”* raised in Paragraph # 65.

No consolidated financial statements

In Canada, for tax and estate planning purposes, a private company may be organized into two or more legal entities but, in fact, those entities may operate as a single economic entity. Those legal entities may be owned by the same shareholders/owners as well.

One segment of the accounting community strongly favours consolidation because the users of the financial statements (see discussion on GPFS in our section General Remarks) find information of the economic entity more useful than the information pertaining to the legal entities because these entities often enter into transactions with each other. Such transactions may not be structured or priced at arms length basis. The entities are jointly managed and loans are cross-collateralised. Therefore, this segment of the community supports that the financial statements must reflect the financial position, operating results, and the cash flow of the economic entity; not the individual legal entities. This community cites that, presently, the Differential Reporting (DR) prescribed in Canada provides exemption, i.e., not to consolidate if agreed to by all shareholders as a major problem because operating company and holding company owners can manipulate results. It is

believed by these proponents that through consolidated results, the generic users are better served.

An opposing view of the accounting community is that a majority of private companies do not have sophisticated accounting departments and consequently rely on external accountants to prepare the year-end financial statements. Owners want to know how each company (or component) of their business has performed and do not appreciate any necessity to aggregate (i.e., consolidate). As clients, they wish to minimize additional fees for GAAP level services that they do not welcome or require. This community cites that current Differential Reporting as prescribed in Canada provides exemption; i.e., not to consolidate if agreed to by all shareholders.

Through careful analysis of various scenarios, we provisionally support the views expressed by the IASB's IFRS for SMEs Exposure Draft in that the users of financial statements are advantaged to know the results of the economic entity. That is, to the extent that the results of the IASB field testing may or may not bear that out.

Paragraph # 66 expresses concerns that the flexible aspect of differential reporting "*hampers comparability, not only with publicly accountable enterprises but also among private enterprises*" but does not provide the means how AcSB would mitigate the non-comparability aspects of differential reporting.

We see Option # 1 to be the same as the proposed IFRS for SMEs where the simple options in each of the full IFRS are proposed for the private companies. Presumably, the AcSB's approach would mimic what has already been done by the IASB. What the AcSB is really saying here is that for Canadian constituents we would define what the simpler option is rather than the IASB and, also for you the owner manager we would define what is simple and cost effective for you regardless of what you have told the IASB in field-testing.

In our view, the question # 1 has been answered by the IASB in that they have published an IFRS for SMEs Exposure Draft and, in trying to make it more useful and relevant to its constituents, it is trying to ascertain what difficulties, if any, in practice might be faced by private companies. Also, CGAs in our roundtable discussion meetings have told us that the IFRS for SMEs is a viable product. They consider the IFRS for SMEs Exposure Draft to be an excellent document; it provides substantial information; it is well organized, well indexed, and in it most terms are well defined. All things taken together, the IFRS for SMEs is simpler than full IFRS – a necessary condition if it is to be embraced by private companies.

The second question asked was: If the AcSB were to develop Differential Reporting standards based on IFRS, what type of Differential Reporting is preferable, "mix-and-match" or "all-or-nothing"? We believe, the AcSB should not develop its own differential reporting standards for the private companies because in doing so it would put Canadian private companies at a disadvantage globally.

Option 2 — Adoption of the IFRS-SME, with or without modification

The IASB has released a proposed standard for small and medium-sized enterprises (the IFRS-SME) to provide a simplified, self-contained set of accounting standards appropriate for smaller, non-listed companies. The proposed IFRS-SME is based on the full set of IFRS developed primarily for listed companies. (The IFRS-SME Exposure Draft and Basis for Conclusions can be found at www.iasb.org.)

Option 2 entails adopting the IFRS-SME, perhaps with some modification to meet the needs of Canadian private enterprises.

This option will provide some degree of linkage, depending on how much the final IFRS-SME differs from the full IFRS and the number of modifications necessary to “Canadianize” the IFRS-SME. The IFRS-SME is based on the IFRS and is expected to be updated periodically as IFRS change, so it is likely that the IASB will maintain some degree of linkage between full IFRS and IFRS-SME.

A summary of the IFRS-SME and the AcSB’s assessment of the advantages and disadvantages of this option are set out in paragraphs 67-75 of the Discussion Paper.

High-level comments to various paragraphs in this part of the Discussion Paper are provided below:

With respect to Paragraph # 68; it should be added that the Draft IFRS for SMEs is undergoing field testing and comment-letters-reviews are proceeding and, subsequently, depending upon the results so obtained, the Draft would be updated. It is expected that the standard would be released in mid-2008. Also, CGA-Canada’s comment letter to the IASB contains its views regarding recognition and measurement simplifications as identified in this paragraph therefore they are not duplicated here.

Paragraph # 69 states, “A preliminary review of a draft of the IASB exposure draft, and views expressed by Canadian stakeholders in the deliberation of the various differential options permitted under Section 1300, Differential Reporting, have led the AcSB to tentatively conclude that the positions taken on some important technical issues in the proposed IFRS-SME are unlikely to find general acceptance in Canada, such as the treatment of “high-low” redeemable preference shares issued in tax planning arrangements.”

There are all sizes of publicly accountable and private companies. Generally, there are the same types of stakeholders of private companies as are for the publicly accountable enterprises (as noted in our General Remark # 1 “General Purpose Financial Statements”) and also it should be noted here that a financial transaction

that is applicable to a private company would also be applicable to a listed company and vice versa.

Paragraph # 69 above, provided as an example that the position taken on the *“treatment of “high-low” redeemable preference shares issued in tax planning arrangements”* in the proposed IFRS for SMEs might not find general acceptance in Canada.

During our discussion meetings, however, the members identified two specific types of transactions that might be considered as specific Canadian circumstances/ transactions that treatment in the proposed IFRS for SMEs of such transactions might not find general acceptance in Canada: Individual Pension Plan (IPP) and “High/low” redeemable preference shares.

These transactions are discussed below:

Individual Pension Plans (IPP)

During our discussions, several participants expressed the view that in Canada, generally private companies do not offer defined benefit plans therefore they suggested that the IFRS for SMEs should only discuss accounting for defined contribution plans. However, some private companies do offer an Individual Pension Plan (IPP) which is briefly described below:

Individual Pension Plan is best suited for business-owners and incorporated professionals and senior executives who work for incorporated businesses. The employer makes plan contributions. The contribution amount is computed actuarially and depends on the age of the member and his or her reported salary history (T4 reported earnings). Under the federal and provincial regulations, an IPP is considered to be a defined benefit plan. Thus, if the market drops, additional tax-deferred contributions can be made to make up the shortfall. There are several other technical issues however what we wish to point out is that an IPP is considered a defined benefit plan. Thus, the private company liability should be reported based upon the standards of reporting for the defined benefit plans.

Consequently, we support the inclusion of a defined benefit section in the IFRS for SMEs.

“High/low” redeemable preference shares

There is however a particular instrument in Canada referred to as “**high/low**” **redeemable preference shares** that require some elaboration because the guideline afforded by IFRS for SMEs Exposure Draft and until recently the guideline provided by Canadian standards might not suffice.

In Canada, “high/low” redeemable preference shares are commonly issued in estate freeze arrangements in private companies. The owners of the private companies enter into such arrangements purely for tax-motivated purposes. Therefore, the EIC – 69 (Emerging Issues Committee) discussed the application and arrived at a consensus position that these shares constitute financial liabilities when they are mandatory redeemable for cash or other financial assets on demand by the holder. Similar to a demand note, the issuer of high/low shares would measure its liability based on the redemption amount of the shares. The holder’s intention to redeem or not, or the inability of the issuer to satisfy the call if so requested is substantively irrelevant.

With the introduction of Section 3860 (which is similar to IAS 39) on January 1, 1996, an article in CA Magazine (November 1996) in Canada³ discussed the issue, which had earlier been discussed in EIC – 69 and its applicability within Section 3860. This Section states that the issuer of a financial instrument should classify it as a liability or equity in accordance with the substance of the contractual arrangement. This statement applies to all types of instruments whether they are traditional or innovative. In fact, this statement applies to everything an accountant encounters professionally.

At that time, the article stated that the industry raised two concerns: 1. they do not agree that the result best reflect the substance of the obligation, and 2. the new standards create adverse consequences for some businesses. The author goes on to state that in the judgement of the standards-setter “... it is better to present high/low shares as liabilities ...” because that is what the substance of the transaction is.

Also, the Chartered Financial Analysts (CFA) Institute’s program of studies considers these types of shares as liabilities. Interestingly though, it should be noted that tax authorities in Canada accept these shares as equity.

At least in part prompted by tax treatment, on September 1, 2007, the AcSB withdrew the EIC - 69 and subsequently, changed the accounting standards effective October 2007, to conform to the stipulated tax treatment⁴. It is an unfortunate situation where tax treatment is driving the accounting for the

³ “Liability or equity?”, Peter Martin CA, CA Magazine November, 1996.

⁴ It should be noted that Paragraph # 9 of the Discussion Paper states, “GAAP is, however, developed independently of the legislative, regulatory and other requirements of particular jurisdictions.”

transaction and the standards-setter is ill pressed to adversely circumvent the tax provision. In so doing, the substance of the transaction can be marginalized.

Because of the changed position of the AcSB, if these shares are presented as liabilities in the financial statements, as the substance of the transaction indicates:

- The auditors would be required to qualify their opinion.

However, the Appendix E, Paragraph E 29 of the Discussion Paper states, *“Project staff understands that, generally speaking, private companies have the ability to depart from GAAP. Their financial statement users as a whole often accept qualified reports.”*

Thus, a qualified audit opinion is not a major problem for the private companies.

If a private company reports amount of the shares as a liability in the financial statements and provides a reconciliation of the equivalent amount as equity in the notes to the financial statements; this issue does not seem insurmountable anymore.

- Also, if the private company’s agreement with the lender (bank) states that the covenants should be calculated based on the information on the face of the financial statements then the owners of the private company might become in violation of some covenants.

Therefore, the owners of the private companies should try to convince the lenders to compute covenants ratios based on the information provided in the notes to the financial statements as well. In our view the lenders/banks should not have any problems because they normally recast the financial statements anyway to determine the financial health of the company.

Our view is supported by Paragraph E8 in the Appendix E of the Discussion Paper which states, *“Bankers and other lenders, such as credit unions, were identified as the key external user of private company GAAP financial statements, but they adjust financial statement amounts to meet their own particular needs, rather than placing direct reliance on such information.”*

Therefore, if the reconciled amounts are provided in the notes; the lenders would be able to easily re-compute the necessary information.

If the agreement with the bank states that the covenants should be calculated using financial statements then the private companies’ owners should, on going forward basis:

- Convince the lender to calculate all ratios based on the information provided, including the notes, and or
- Have the agreement modified appropriately. We believe it should not be too difficult to convince the lender to modify the agreement.

Thus, the AcSB should permit the private company to recognize the high/low redeemable preference shares in the financial statements as liabilities and accept the reconciliation in the notes to the financial statements as equity for tax reporting purposes.

In doing so, the private company would get best of all worlds: have their financial statements prepared with the, expected to be, globally accepted private company accounting standards, i.e., IFRS for SMEs; yet, be compliant of the lenders' covenants; and, also report the shares based on the substance of the transaction which the CFA Institute has also pronounced them to be a liability rather than the form of the transaction, i.e., equity.

Also, Paragraph BC 30 of the Basis for Conclusions in IFRS for SMEs states that tax authorities often look to financial statements as the starting point for determining taxable income. Therefore, profit or loss determined in conformity with the proposed IFRS for SMEs can serve as the starting point for determining taxable income in a given jurisdiction by means of a reconciliation that is easily developed at a national level.

CGA-Canada supports this view rather than the implicit approach inherent to the Canadian approach that the profit and loss is determined using the tax base and then reconciled in the notes, if necessary, with the IFRS for SMEs for any domestically developed standards. In so doing; the main advantage of being able to compare like entities in different jurisdictions is tainted.

Paragraph # 70 states, *“It is also possible, of course, that the final Canadian standard, after respondents have commented on specific technical issues, will not differ materially from the IFRS-SME.”*

Under those circumstances, it does not make sense to modify the IFRS for SMEs. Also, Paragraph E8 in the Appendix E, with respect to lenders and credit unions, states that *“There is no demand from them for a separate or modified set of accounting standards for private companies.”*

This comment may be interpreted as that the lenders and credit unions don't need a separate set of private company standards that are specially developed for the private companies either by the IASB or the AcSB; they would be happy to work with the full IFRS. Isn't this telling to all standards setters?

Paragraph # 71 lists several advantages of the stand-alone approach without modifications to the IFRS for SMEs including, *“It would not be reinventing the wheel. It would be using, as a starting point, a well-reasoned document that has gone through an extensive due process. The ongoing maintenance of the standards will be primarily the responsibility of the IASB. Canadian involvement would be limited to reviewing and commenting on any changes proposed by the IASB and updating the draft to reflect Canadian circumstances.”*

We support this view.

Paragraph # 72 states, *“Condensation and simplification often eliminate information and guidance that would be helpful to private enterprises. This could be particularly problematic for standards that tend to be complex (generally the standards dealing with more complex transactions and circumstances on which more guidance might be particularly helpful). Condensed standards may not necessarily cover all the issues and events facing private enterprises.”*

The IFRS for SMEs include a GAAP hierarchy (please see our discussion under General Remark # 5, “Hierarchy, i.e., General referral to full IFRS”). It provides that when an enterprise encounters an issue that has not been explicitly dealt with in the IFRS for SMEs, the enterprise should try to find answer in the IFRS for SMEs by analogy and by using the concepts and pervasive principles included in the IFRS for SMEs standard. However, an enterprise should look to full IFRS as a safety net only if an answer cannot be found otherwise, but this is not mandatory.

Paragraph # 72 notes, *“As noted in Appendix E, users were quite clear in expressing their need for consistent interpretation of the same fact pattern and also their desire for high-quality financial reporting.”*

We support this sentiment.

Paragraph # 72 comments, *“Amending the IFRS-SME for private enterprises is inconsistent with the decision to adopt full IFRS without any amendments for publicly accountable enterprises. It would diminish the ability to compare Canadian private enterprises with those in other countries, especially if a large number of differences were allowed.”*

We support this view.

Paragraph # 72 also states, *“On the other hand, proponents of this approach maintain that comparability with enterprises in other countries, with the possible exception of the United States, is not really an issue for the vast majority of Canadian private enterprises. External users of private enterprises, particularly bankers and other lenders are primarily domestic.”*

The comparability issues have been addressed in our discussion on Paragraphs # 56 and # 57 under General Remark # 2 “Evolving from a small to large private company or to a small/large listed company” and with respect to above comment pertaining to the bankers and other lenders please see our discussion on Paragraph # 61 under Option # 1.

Paragraph # 72 further states, *“The IFRS-SME does not require mandatory fallback to full IFRS when a SME has a particular issue that is not addressed under the IFRS-SME. This could also result in inconsistent interpretations, which would reduce comparability.”*

The IFRS for SMEs is a principles-based standard. Therefore, within the bounds of the professional judgement of the professional accountant; a small variation in the results is acceptable.

Paragraph # 72 also states, *“The IFRS-SME could evolve to be quite different from full IFRS over time. This would diminish its usefulness to those who want consistency and comparability with information produced in accordance with full IFRS.”*

In our view it is not likely because the IFRS for SMEs will continue to provide for simpler options within the full IFRS; however, we concede that theoretically it is possible that it could evolve to be quite different over time whereas, a domestically developed standard or domestically modified IFRS for SMEs standard for private companies would definitely evolve to be quite different.

Paragraph # 73 states, *“A critical issue in the stand-alone approach is the relationship and interaction between the IFRS-SME and full IFRS. The proposed IFRS-SME includes a GAAP hierarchy that differs in some important respects from the corresponding GAAP hierarchy in full IFRS. When the IFRS-SME does not deal with a particular matter, as will sometimes be the case, a private enterprise is permitted, but not required, to refer to any relevant material in the full IFRS. This presents both advantages and disadvantages. On the one hand, it enables condensation and simplification to be effective, with greater reliance on principles and the exercise of professional judgment. On the other hand, it creates the considerable risk of diversity of practice both among private enterprises and among private and publicly accountable enterprises. The gulf between practices in the private and publicly accountable sectors could widen over time.”*

We don't agree with your views; please see our comments related to Paragraph # 72 above.

Paragraph # 74 states, *“Diversity in practice may not be particularly troubling for those involved only in private enterprise financial reporting. Why should they be expected to be aware of the detailed requirements of full IFRS? It could, however, be more of a problem for those actively involved in the financial reporting of both private and publicly accountable enterprises. For example, public accountants might be uncomfortable being associated with private enterprise financial statements when they know, or may*

be expected to know, that certain accounting treatments are not consistent with the more detailed requirements of full IFRS.”

We don't agree with your views; please see our comments in General Remark # 3 “Stand alone document.”

Paragraph # 75 states, *“Condensation and simplification do not necessarily compromise the robustness of the standards or the quality of the information provided. Indeed, the draft IFRS-SME arguably produces superior information in some cases because of stricter adherence to principles. For example, the section on post-employment benefits requires that pension assets and obligations be measured in the same way as for publicly accountable enterprises, but does not allow the corridor method or any other mechanisms that defer and amortize gains and losses over future periods. Some may find it rather ironic that private enterprises would be held to a higher standard than publicly accountable enterprises, at least as matters stand under current IFRS and the proposed IFRS-SME.”*

Current Canadian standards permit the “corridor approach” for smoothing the amounts, as does the full IFRS. In the IFRS for SMEs Exposure Draft, favour is afforded to recognizing actuarial gains and losses in full in profit and loss because this is the simpler option. We agree because it also provides more transparency; whereas smoothing doesn't⁵. Also, we expect that when the IASB reconsiders the pension accounting in collaboration with other domestic standards setters; the corridor approach and other smoothing mechanism would not find favour within the new standard.

Option 3 — An independently developed set of standards

Under this option, the AcSB would develop a set of standards independent of the standards for publicly accountable enterprises. This could be a “fresh start” or use existing standards as a source. It would, however, be based on the conceptual framework (see paragraphs 28-44 of the discussion paper).

This option is less clearly delineated than the other two because, unlike them, it does not have clear points of reference. Respondents who favour this option are asked to be as specific as possible in identifying and describing the principal features they believe to be essential.

This option may, or may not, provide linkage to the standards for publicly accountable enterprises. It is possible that, if this option were adopted, the specific requirements may not differ extensively from those for publicly accountable enterprises. Then, again, they might.

⁵ “Addressing the Pensions Dilemma in Canada”, 2004, Rock Lefebvre and Amar Goomar, Certified General Accountants Association of Canada; accessible on CGA website.

The AcSB has concluded that a “frozen” set of standards is not workable. Option 3 will involve periodic improvements following adoption of the initial set of standards. Evolution may, or may not, be based on evolution in the IFRS applied by publicly accountable enterprises.

Paragraphs 76-82 of the Discussion Paper provide a more detailed discussion of this option, together with the Boards’ assessment of its advantages and disadvantages.

High-level comments to various paragraphs in this part of the Discussion Paper are provided below:

Paragraph # 76 provides that this, *“approach would, to a large degree, be a fresh start but it would share the same framework underpinning the IFRS (see paragraphs 28-43). The sources for the development of such a standard have yet to be determined.”*

The IASB’s IFRS for SMEs Exposure Draft, save results of the field-testing, has proven to be a superior product and that most countries intend to use it for private companies therefore we are at a loss as to what is the need to reinvent the wheel at an exorbitant cost of maintaining those new domestically developed standards.

With respect to current Canadian standards, Paragraph # 77 states, *“They have been developed in the context of Canadian circumstances, so there is no need to “Canadianize” them. Since Canadian private enterprise constituents are already familiar with these standards, they would not have to spend time learning new requirements.”*

Since present Canadian standards are principles-based and so are the IFRS for SMEs; there are only a few new concepts that are different than the present Canadian standards therefore we don’t see much difficulty in learning the IFRS for SMEs.

The Paragraph # 77 further states, *“Canada could follow an approach similar to what IASB took with its IFRS-SME, condensing the accounting standards included in the Handbook, thereby making them somewhat less intimidating for private enterprise constituents. It might also consider a more grass roots approach.”*

We agree Canada could adopt such an approach but we don’t see any advantages to Canadian constituents or Canadian private companies.

Paragraph # 78 states, *“Canada might want to analyze the differences between full IFRS and the proposed IFRS-SME and other issues covered in the IFRS-SME’s Basis for Conclusions. It might also review the experience of the UK Accounting Standards Board in its work on Financial Reporting Standard for Smaller Entities (FRSSE), now in its fifth edition, along with what the United States learned from its Private Company*

Financial Reporting Committee. Australia, New Zealand and other countries are also examining private enterprise financial reporting.”

If the countries mentioned in the paragraph all developed their own different private companies reporting standards and likewise Canada also did so; all of those countries would have different private company standards. But, we fail to understand benefits to Canadian private companies.

Paragraph # 79 identifies issues that could be covered such as *“greater use of historical cost measurements, rather than fair value; amortization of goodwill and other intangible assets with an indefinite useful life; related party transactions disclosures and measurements from a private enterprise user needs perspective; future income taxes on a basis other than full allocation or taxes payable (for example, partial allocation); and simplification of the requirements for financial instruments.”*

The IFRS for SMEs Exposure Draft has already discussed those issues, analyzed them, and provided rationale for position taken in the Basis for Conclusions.

Here, the Discussion Paper has just listed the issues but has not provided any rationale as to how the AcSB’s analyses and treatment of the issues would provide superior information. It doesn’t identify how such information would be useful for what types of decision-making and whether it would be useful to all or to which type of stakeholders, e.g., owners, managers, investors, rating agencies, minority shareholders, lenders/creditors, venture capitalist, existing or prospective customers and suppliers, and employees as shareholders or just employees. The paragraph does not provide analyses in what areas the proposed IFRS for SMEs fails and how the proposed approach would succeed.

Paragraph # 80 states, *“The appropriate accounting for such issues will need in-depth consideration. The outcome is at present not determinable. The issues are raised to stimulate the identification of fresh ideas, to assist the AcSB in making a realistic assessment of the legitimate differences that might be accommodated in an independent, Canadian stand-alone approach for private enterprise. As previously noted, this approach would not encompass a new conceptual framework developed specifically for private enterprises.”*

We urge the AcSB, as mentioned in General Remark # 4 “Changing role of the domestic standards setter to the domestic gate-keeper”, to collaborate with and provide its expertise to the IASB in making the IFRS for SMEs an improved standard rather than expend effort in developing its own standard that might turn out to be an inferior product.

We do not agree with any of the Pros identified in Paragraph # 81 and agree with the Cons identified in Paragraph # 82 that expresses the inappropriateness of this approach including the one that states, *“it could be construed as unnecessarily reinventing the wheel.”*

Summary

If all countries' had their own standards-setters develop standards that would satisfy the needs of all stakeholders while attempting to achieve balance in continuum, the price of standards development and maintenance including other infrastructure costs would become exorbitant; it doesn't make economic sense. Especially, the standards setters are addressing the same types of financial transactions, i.e., the transactions that are applicable to a private company are also applicable to a listed company throughout the world and vice versa; and they are, also, addressing the needs of the same type of stakeholders. Thus convergence of standards to the IASB makes financial and business sense. The convergence also makes economic sense even more so for the private company standards, i.e., IFRS for SMEs.

The Discussion Paper (DP) raised concerns about the role of the domestic standards setter. This concern is unwarranted, as every jurisdiction would continue to need an **independent** domestic gatekeeper to ensure the IASB standards do not violate any national laws. In our view, the Canadian standards setter should collaborate with the IASB in researching accounting issues of importance and leverage its expertise developed over the years in helping the IASB develop quality standards.

The DP identified one type of specific transaction that is unique to Canada, i.e., "high/low" redeemable preference shares that are issued in estate freeze arrangements. Our analysis addresses how they may be recognized in the IFRS for SMEs.

Conclusion

The AcSB should neither develop its own differential reporting standards for the private companies nor modify the IFRS for SMEs because in doing so it would put Canadian private companies at a disadvantage globally.

Because of the globalization of the marketplace and the concomitant desire for some uniformity and comparability, the application of IFRS for SMEs can help in decision-making. In mergers and acquisition activities within a jurisdiction or on an international basis - - in seeking to lower the cost of capital - - in participating in multi-jurisdictional supply chains - - in bolstering comparability of financial statements by investors residing in different jurisdictions, etc., IFRS for SMEs can be of significant value. While not the object of this comment paper, the provision of IFRS for SMEs can intuitively facilitate moving down from full IFRS to IFRS for SMEs or moving up from IFRS for SMEs to full IFRS; etc. This may have some appeal for some.

While the matter will be further analysed and deliberated domestically and abroad, CGA-Canada continues to be supportive of the IFRS for SME initiative and recommends that the General Purpose Financial Statements prepared in accordance with the eventual English language version of IFRS for SMEs as published by the IASB, without modification, be adopted by Canada.

In closing, we congratulate the AcSB on its open mind to explore various options and look forward to the results of the Invitation to Comment. CGA-Canada also welcomes future exchanges and encourages the AcSB to correspond with Amar Goomar at agoomar@cga-canada.org or Rock Lefebvre at rlefebvre@cga-canada.org should further elaboration be desired.

Sincerely,

[Original signed by :]

Anthony Ariganello, CPA (Delaware), FCGA
President and CEO