

## ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

Accounting Standards for Private Enterprises (ASPE) are a revised set of Canadian generally accepted accounting standards available for private enterprises which will impact your upcoming financial reporting period and accompanying financial statements. You may have already heard of ASPE and be well on your way to identifying the changes ASPE will have on financial reporting. For others, this may be the first you have heard of ASPE. In short, ASPE were developed to meet the needs of private enterprises and the typical users of private entity financial statements. The standards recognize that private enterprises may have limited ability to apply overly complex accounting standards.

To assist you in gaining an understanding of ASPE we have compiled a brief synopsis of what ASPE is, some of the electives you, as a financial reporter, can choose and the steps you need to take to be ready for your upcoming review or audit. Of course we encourage as many questions between now and your upcoming financial reporting period end so that your adoption of ASPE is as smooth and efficient as possible.

“ The standards recognize that private enterprises may have limited ability to apply overly complex accounting standards.”

Now is the time to familiarize yourself with ASPE. Waiting until it is time to report will not allow you, as a preparer of financial information, the necessary time to assess and interpret what the new standards mean to you, your lenders, those that enter into contracts with you, your suppliers and even your Human Resources and IT departments. ASPE is far reaching. Let's get started!

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### TRANSITIONAL OPTIONS AND ACCOUNTING POLICY CHOICES UNDER ASPE

ASPE applies for fiscal years beginning on or after January 1, 2011, to all private enterprises that have prepared their financial statements in accordance with Canadian generally accepted accounting principles (GAAP) and choose not to adopt International Financial Reporting Standards (IFRS). Note that for the purposes of this guide, the transition date to ASPE is the beginning of the comparative year in the first set of ASPE prepared financial statements.

Accordingly, the following applies if we assume a December 31 year end:

- The last financial statements issued under pre-changeover Canadian generally accepted accounting principles (“Old GAAP”) will be for the year ended December 31, 2010 and will have to be restated in accordance with ASPE for comparison with the financial statements for the year ended December 31, 2011.
- A balance sheet as at January 1, 2010 will have to be prepared in accordance with ASPE. The balance sheet as at December 31, 2011 will have three columns (one for each balance sheet date), each prepared in accordance with ASPE:

Balance sheet as at December 31, 2011	Balance sheet as at December 31, 2010	Opening balance sheet as at transition date January 1, 2010
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## CHOOSING TRANSITIONAL OPTIONS AVAILABLE ON FIRST-TIME ADOPTION

Section 1500 “First-time Adoption” outlines the requirement to retroactively apply ASPE as though these new accounting standards had always been followed since inception of the entity. The section also provides entities the ability to elect not to restate certain aspects of the financial statements at the transition date however, accounting policy changes resulting from elections made in the transition to new standards will have to be applied and disclosed in accordance with “Accounting Changes”, Section 1506.

In other words, the balance sheet as at the transition date will be presented as if the entity had always applied ASPE, except for when one of the elections discussed below is used. The cumulative effects of any restatement, as a result of the changeover to ASPE, will be reflected in opening retained earnings for the comparative period. Subsequent to transition, the accounting policies elected will be applied on an ongoing basis.

“The cumulative effects of any restatement, as a result of the changeover to ASPE, will be reflected in opening retained earnings for the comparative period.”

Section 1500 “First-time Adoption” allows for the entity to elect, at the transition date, any of the following (one-time) exemptions from retrospective restatement:

- a. Business combinations (see paragraphs 1500.10 and .11)
- b. Fair value of property, plant and equipment (see paragraphs 1500.12 and .13)
- c. Employee future benefits (see paragraphs 1500.14 to .16)
- d. Cumulative foreign currency translation differences (see paragraphs 1500.17 and .18)
- e. Financial instruments (see paragraphs 1500.19 to .21)
- f. Stock-based compensation and other stock-based payments (see paragraphs 1500.22 and .23)
- g. Asset retirement obligations (see paragraph 1500.24)
- h. Related party transactions (see paragraph 1500.25)

### A. BUSINESS COMBINATIONS

Section 1582 “Business Combinations” requires retrospectively applying the Section by recognizing and reclassifying transactions that meet the definition of a business combination as if they had always been accounted for under ASPE. All intangible assets which would have been recognized as a result of ASPE would be required to be recognized. Any intangible assets disallowed under ASPE would also have to be derecognized.

With regards to business combinations, the elective exemptions found in Section 1500, “First-time Adoption” allow the entity the option to:

- 1) Retrospectively apply Section 1582 “Business Combinations” to previous business acquisitions after a selected date that is prior to the transition date by choosing one business combination to be the first to be restated; or
- 2) Not to apply Section 1582 “Business Combinations” retrospectively before the transition date. The entity maintains the same accounting treatment as in its previous financial statements and recognizes all assets and liabilities that were acquired or assumed in a past business combination, except for financial assets and liabilities derecognized in prior periods. Any item recognized under Old GAAP that does not qualify for recognition as an asset or liability under ASPE is excluded from the opening balance sheet, with any resulting change accounted for by adjusting retained earnings unless the change results from recognition of an intangible asset that was previously subsumed within goodwill. If the change is an intangible asset reclassified as goodwill, there may be no requirement to adjust retained earnings.

Note that any business combinations that occurred in the comparative year must be accounted for using ASPE. The business combinations that can be elected to be exempt from the application of Section 1582 “Business Combinations” must have occurred before the transition date. If any business combination is restated to comply with Section 1582 “Business Combinations”, the entity must also apply Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests” from the same date of the first restatement.

## B. FAIR VALUE OF PROPERTY, PLANT AND EQUIPMENT (“PP&E”)

As of the date of transition, the entity is given two options for measuring PP&E:

- 1) Measure the carrying amount in accordance with “Property, Plant and Equipment”, Section 3061; or
- 2) Elect to measure a selected item of PP&E at fair value at the date of transition with changes applied to retained earnings. The fair value will become the deemed cost of the asset as of the transition date.

Note that there is a cost associated with the election to use fair value since entities must measure the fair value of the asset for accounting purposes, which will generally require an expert’s valuation report.

When deciding on the use of fair value the following should be considered:

- An increase in assets and equity;
- A reduction of the debt/equity ratio;
- An increase in the subsequent depreciation expense.

## C. EMPLOYEE FUTURE BENEFITS

At the date of transition, entities with one or more defined benefit pension plan must choose between two alternative accounting policies, one of which is the deferral and amortization approach, that was required under Old GAAP. The entity may choose instead to adopt the immediate recognition approach described in “Employee Future Benefits”, Section 3461. All deferred benefit pension plans must be accounted for in the same manner.

“...entities with one or more defined benefit pension plan must choose between two alternative accounting policies...”

### *Deferral and Amortization Approach*

Under this approach, the entity would have to recalculate the actuarial gains and losses from inception of each of its defined benefit plans to determine the cumulative amounts at the transition date, unless it elects one of the following:

- 1) The entity may elect the “corridor” approach that carries forward unrecognized actuarial gains and losses and past service costs; or
- 2) The entity may elect to recognize all accumulated actuarial gains and losses and past service costs in opening retained earnings at the transition date, even if the deferral and amortization approach is used for later actuarial gains and losses.

Using an election may lead to:

- Positive earnings in the future as no actuarial losses will need to be amortized into income;
- Certain covenants and ratios could be impacted from the recognition of actuarial gains and losses into retained earnings. This may in turn impact finance arrangements and corresponding covenants.

### *Immediate Recognition Approach*

This approach calls for the entity to use an actuarial valuation for funding purposes for balance sheet recognition of the accrued benefit obligation net of the fair value of any plan assets. This accounting policy choice requires that all unamortized actuarial gains and losses are recognized on the balance sheet with the corresponding offset in opening retained earnings at the date of transition. The cost of the plan for each subsequent year is recognized in net income.

This approach may lead to:

- A less costly and complex method of accounting for defined benefit pension plans;
- Increased volatility in net income since the entity immediately expenses all changes in plan obligations; and
- No amortization expense related to past services or actuarial gains or losses.

## D. CUMULATIVE FOREIGN CURRENCY TRANSLATION DIFFERENCES

Under “Foreign Currency Translation”, Section 1651, entities classify the differences from the translation of a self-sustaining foreign operation as a separate component of equity. On disposal of part or all of the operation, the cumulative translation difference is included in the income statement as part of the gain or loss on disposal.

However, a first-time adopter need not comply with those requirements for cumulative translation differences that existed at the date of transition if it elects to recognize the cumulative translation differences, for all foreign operations, which are deemed to be zero, in opening retained earnings at the date of transition. The gain or loss on a subsequent disposal of any foreign operation will exclude any translation differences that arose before the date of transition however, will include subsequent translation differences.

## E. FINANCIAL INSTRUMENTS

Financial instruments must be initially recognized at fair value and can be subsequently measured at either amortized cost or fair value.

At the date of transition, the entity may elect to re-designate any financial asset or financial liability to be measured at fair value regardless of the previous accounting treatment. The entity may also elect not to separate the components of a financial instrument that contains both a liability and equity component, provided that the liability component is no longer outstanding as of the transition date. This change will be reflected in retained earnings on the entity’s opening balance sheet.

“...the entity may elect to re-designate any financial asset or financial liability to be measured at fair value regardless of the previous accounting treatment...”

## F. STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

For stock-based compensation and other stock-based payments, Section 1500 provides two elections that entities can choose:

- 1) The entity can elect not to retroactively apply the recognition and measurement requirements of Section 3870 “Stock-based Compensation and Other Stock-based Payments”, to payments or compensation granted or issued prior to the date of transition. Disclosure will still be required under the applicable section. Note that this election will be beneficial to the entity that did not account for stock-based compensation in accordance with Old GAAP and whose equity instruments granted remain exercisable at the date of transition.
- 2) Where an entity previously used the minimum value method when awarding stock-based compensation prior to the date of transition it can elect to not apply the calculated value method to these awards thereby not having to re-measure the compensation awarded before the date of transition. Note that

under the minimum value method, volatility can be excluded from the computation of the value of an option, whereas the calculated value method requires the use of volatility in the determination of an options value.

## G. ASSET RETIREMENT OBLIGATIONS (ARO)

When considering asset retirement obligations, Section 3110 “Asset Retirement Obligations” requires AROs to be accounted for on the date the asset becomes available for use. The entity would measure the obligation at the date it was incurred as if the entity had always applied ASPE. The depreciation and accretion expenses will have to be calculated for all previous years and will be an adjustment to retained earnings on the opening balance sheet.

Instead, an entity can elect to measure the obligations at the date of transition and estimate the amount based on the original and remaining life of the asset. The difference between the obligation and the amount to be recorded on the opening balance sheet will be charged to opening retained earnings. This will allow entities who had not previously recorded AROs, in accordance with Section 3110, a way to record them as of the date of transition.

## H. RELATED PARTY TRANSACTIONS

Section 1500 allows for entities to elect not to restate assets and liabilities related to transactions with related parties prior to the date of transition that were not previously recognized in accordance with Section 3840 “Related Party Transactions”. Note that this may not be relevant to entities which followed the related party transaction guidance under Old GAAP, but rather those with new-adoption of ASPE and who had not previously issued GAAP compliant statements.

“Section 1500 allows for entities to elect not to restate assets and liabilities related to transactions with related parties prior to the date of transition...”

Additionally, transactions between the entity and management, where the sole relationship is in the capacity of management, will be subject to new measurement standards; however the same disclosure requirements apply as with any other related party transaction.

## OTHER MATTERS IN TRANSITION TO ASPE

In addition to the elections available above, the following matters should be considered in the first-time transition to ASPE.

### EXCEPTIONS TO RETROSPECTIVE APPLICATION

#### A. DE-RECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

For de-recognition of non-derivative financial assets or liabilities, under Section 3856 “Financial Instruments”, the entity can only prospectively apply these standards to transactions occurring on or after the date of transition. The entity may apply the de-recognition requirements in Section 3856 retrospectively from a date of the entity’s choosing, prior to the transition date, provided the information needed to derecognize the transactions was obtained at the time of initially accounting for those transactions.

#### B. HEDGE ACCOUNTING

Section 1500 prohibits the retrospective designation of hedge transactions before the date of transition. All hedging relationships reflected in the opening balance sheet must therefore have been designated as such in

previous financial statements and must qualify for hedge accounting under Section 3856.

### C. ESTIMATES

Certain elements on the opening balance sheet will require adjustments to meet ASPE criteria. If these items were accounting estimates, the estimates must reflect conditions that existed at the date of the opening balance sheet transition date (no use of hindsight is permitted). Estimates that are not required to be changed in the transition to ASPE must be consistently applied upon transition and can only be changed if they meet the criteria set out in Section 1506 “Accounting Changes”. Note that errors must be separately disclosed if discovered and cannot be considered to be a change in estimate.

“*Estimates that are not required to be changed in the transition to ASPE must be consistently applied upon transition and can only be changed if they meet the criteria set out in Section 1506 “Accounting Changes”.*”

### DISCLOSURES

In transitioning to the new standards, entities will be required to disclose the following information in their first complete set of ASPE financial statements:

- The amount and reason of each charge to retained earnings at the date of transition as a result of applying Section 1500. If there are no changes, a statement to that effect should be disclosed.
- A reconciliation of net income reported in an entity’s most recent previously issued financial statements under Old GAAP to its net income reported for the same year under ASPE. No reconciliation is required if there were no changes.
- Material adjustments to the cash flow statement (if it was previously presented).
- Elections and exemptions the entity used under Section 1500.
- An opening balance sheet upon the date of transition

### COMPARATIVE FINANCIAL INFORMATION

Upon first-time adoption of ASPE, comparative financial information will be marked as “unaudited” unless the comparative information is audited in accordance with ASPE. This will be done even if in the prior year, financial statements had been audited in accordance with Old GAAP. The entity may determine that comparative financial information presented within their financial statements should be marked as audited for a variety of reasons such as but not limited to, requirements sent out in bank agreements, supplier agreements, shareholder arrangements or any other agreement or requirement. We can certainly address the need for audited comparative financial information and would be delighted to discuss this with you further.

“*The entity may determine that comparative financial information presented within their financial statements should be marked as audited for a variety of reasons....”*”

### READY! SET! GO!

The transition to ASPE and the impact to your financial statements cannot be determined without the proper analysis and consideration. The transition to IFRS, which is well underway for public companies, has proven that up front planning and early discussions with your accounting firm paves the way for a timely and successful transition from old to new Canadian GAAP. We encourage you to address this transition early on and welcome any questions you might have. For more information on ASPE and to start the transition dialogue, contact the partner responsible for your entity.

Web resources are also available at <http://www.cica.ca/privateenterprises/index.aspx>

## ABOUT SF PARTNERSHIP

SF Partnership, LLP is a full service, mid-market, public accounting firm providing a wide range of services to private and public entities, in a variety of industries. We work with our clients to improve profitability, minimize tax and address business management concerns. We are committed to our clients' success. We are a proud member of BKR, a respected international association of member firms that allows us to serve our clients' interests around the world in a timely and seamless manner. Our standards for client service and our approach to adding value, combined with the quality of our people are what differentiate our firm and make us a leader in the field of public accounting.

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