Ninth Edition

MODERN ADVANCED ACCOUNTING IN CANADA

HERAUF HILTON

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9TH EDITION

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Modern Advanced Accounting in Canada
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Contents in Brief

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Preface

Welcome to the ninth edition of *Modern Advanced Accounting in Canada.* This book's reputation as the most current and technically accurate advanced accounting text on the market has been not only been maintained but improved upon in this new edition. This edition is 100 percent compliant with International Financial Reporting Standards (IFRS), not only with regard to the typical advanced accounting topics of business combinations and foreign currency transactions, but also for the topics studied in intermediate accounting and other courses. It also contains the reporting requirements for private enterprises and not-for-profit organizations. All of the extracts from financial statements are taken from Canadian entities.

The book reflects standards expected to be in effect as of January 1, 2020, based on standards approved by the IASB or on exposure drafts that were outstanding as of December 31, 2018. We have made every effort to illustrate and explain the requirements of the standards current at the time of publication, anticipating how these might change, what the effects of the changes will be, and what they will mean to the industry, professionals, and students.

We have also continued the presentation of advanced accounting topics that has been well received by so many instructors and students. Emphasis on the direct approach of preparing consolidated financial statements along with the "building block" development of the basics of consolidations has been maintained and strengthened. The working paper approach is illustrated in Chapters 3, 4, and 5, in either the body or the appendices. Excel worksheet files are available online to support the use of the working paper approach for 14 self-study problems and 17 end-of-chapter problems. The number of algorithmic problems with up to 25 versions of end-of-chapter problems has been maintained at six to ten problems per chapter.

As requested by instructors on behalf of their students, the following enhancements have been made in this edition:

- At least one case has been revised in each chapter to encourage critical thinking and classroom discussion. There are five to seven cases in each chapter.
- A new financial statement analysis problem has added to each chapter, and at least one problem has been revised in each chapter.
- The solutions to the cases now contain *CPA Canada Handbook* references to support the recommendations made for each accounting issue.

New Features and Major Changes

- In Chapter 1 more depth has been added to the section on Financial Statement Analysis.
- In Chapter 2 the previous material on available-for-sale investments has been eliminated.
- In Chapter 3 new material has been added from IFRS 13 on techniques to determine fair value, and a new format has been introduced for the schedule to allocate the acquisition differential using plus/minus to indicate debit/credit.
- In Chapter 4 three of the four consolidation theories were renamed and the material on contingent consideration has been enhanced.

- In Chapter 5 and subsequent chapters the schedule to amortize the acquisition differential has been revised to show changes in the acquisition differential. This will make it easier to relate the changes to debits and credits to financial statement accounts.
- In Chapter 6 the appendix on Reporting Land Under Revaluation Model has been deleted.
- In Chapter 7 the appendix on Depreciable Assets Under Revaluation Model has been deleted.
- In Chapter 8 new material has been added on changes in ownership not involving a business.
- In Chapter 9 new material has been added on changes in joint arrangements involving a business.
- In Chapter 10 new material has been added on the segregation of the forward contract into the spot and forward elements.
- In Chapter 11 a real-world disclosure example on foreign operations has been added.
- In Chapter 12 new material has been added on the new *Handbook* sections 4433 and 4434.
- For each chapter the disclosure example from Canadian entities has been replaced with extracts from 2017 financial statements.

Organization

Chapter 1 begins with a survey of the conceptual framework for financial reporting. The remainder of the chapter presents an overview of the different parts of the *CPA Canada Handbook*. Some of the major differences between IFRS and ASPE are identified. A framework to solve an accounting and financial reporting case is discussed in the appendix.

Chapter 2 commences with an overview of the different types of equity investments. The chapter continues with a comprehensive example to illustrate the fair value, cost, and equity methods of reporting investments in equity securities, and it concludes with two self-study problems that compare these different reporting methods. Coverage of the comprehensive example can be postponed until after Chapter 4 without breaking continuity, or omitted altogether if instructors feel that this has been adequately covered in intermediate accounting courses. The material is based exclusively on IFRS 9 Financial Instruments.

Chapter 3 describes three forms of business combinations. The definition of control is discussed and used as the criterion for preparation of consolidated financial statements. The direct and working-paper methods are used to illustrate the acquisition method of accounting for a business combination. The new entity method is mentioned as an alternative method of accounting for business combinations for future consideration. Reverse takeovers are covered in an appendix.

Chapter 4 examines the preparation of consolidated financial statements for non–wholly owned subsidiaries at the date of acquisition. The direct method is used in the body of the chapter and the working paper method is used in the appendix. Four theories of consolidation are mentioned, three of which are illustrated. All four are currently or have recently been required under Canadian GAAP. Accounting for contingent consideration and bargain purchases are also illustrated.

Chapter 5 covers the preparation of consolidated financial statements subsequent to the date of acquisition when the parent uses the cost method in its internal records. The changes to the acquisition differential are explained and illustrated, including an application of the effective interest method. Appendix A provides an enhanced discussion of goodwill impairment. The parent's journal entries under the equity method are summarized. Ten basic steps in the preparation of consolidated statements are introduced, forming the foundation for the consolidation topics in the chapters that follow. The direct approach is used in the body of the chapter. Appendix B illustrates the working paper approach for the same examples used throughout the chapter.

Chapter 6 discusses and illustrates the accounting for intercompany revenues and expenses, as well as intercompany unrealized profits or losses in inventory and land. The revenue recognition, matching, and historical cost principles are used to explain the rationale for consolidation adjustments associated with the holdback and realization of intercompany profits.

Chapter 7 discusses the elimination of intercompany profits in depreciable assets, the recognition of gains or losses resulting from the elimination of intercompany bondholdings, and the related adjustments to income tax. Two self-study problems are presented using the direct approach and involving the effective interest method for bond amortization.

Chapter 8 discusses the preparation of the consolidated cash flow statement and such ownership issues as step purchases, reduction of parent's interest, subsidiaries with preferred shares, and indirect holdings. In all situations, the direct approach is used. The chapter concludes with two self-study problems involving changes in ownership and preferred shares.

Chapter 9 examines other consolidation reporting issues, including special-purpose entities, deferred income taxes and business combinations, and segment disclosures. The accounting for joint arrangements is illustrated using the equity method or a form of proportionate consolidation. The chapter concludes with two self-study problems involving joint arrangements and deferred income taxes pertaining to business combinations.

Chapter 10 introduces the topic of foreign currency and four different perspectives in which currencies can be viewed. Foreign currency transactions and the concepts of hedging and hedge accounting are discussed. The handling of foreign currency gains and losses is illustrated, as is the accounting for fair value and cash-flow hedges. The appendix describes how discounting can be applied when determining the fair value of a forward contract.

Chapter 11 concludes the foreign currency portion of the text by examining and illustrating the translation and subsequent consolidation of subsidiaries whose functional currencies are the same as the parent's and whose functional currencies are not the same as the parent's functional currency. The reporting of exchange gains and losses in other comprehensive income is also illustrated. The chapter concludes with two self-study problems on the translation of a foreign operation under the two translation methods and the preparation of consolidated financial statements after translating the foreign operation.

Chapter 12 discusses in depth the 15 not-for-profit sections in Part III of the *CPA Canada Handbook*. The chapter concludes with a comprehensive illustration of the required journal entries and the preparation of financial statements using both the deferral method and the restricted fund method. Appendix A provides a real-life example of the deferral method by reproducing portions of the financial statements of the United Way/Centraide Ottawa. Appendix B illustrates the accounting for *net assets invested in capital assets* as a separate component of net assets. Appendix C provides a comprehensive outline of the PSAB reporting requirements for federal, provincial, and local governments.

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- **Computerized Test Bank.** This test bank contains over 1,000 multiple-choice, true/false, and problem questions. Each test item is coded for level of difficulty and learning objective.
- **Microsoft® PowerPoint® Presentations.** These slides cover key concepts found in each chapter using outlines, summaries, and visuals.

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CHAPTER 1

Conceptual and Case Analysis Frameworks for Financial Reporting

LEARNING OBJECTIVES

After studying this chapter, you should be able to do the following:

LO1 Describe and apply the conceptual framework for financial reporting.

LO2 Describe how accounting standards in Canada are tailored to different types of organizations.

LO3 Identify some of the differences between IFRS and ASPE.

LO4 Analyze and interpret financial statements to assess the impact of different accounting methods on key financial statement ratios.

LO5 (Appendix 1A) Apply the case analysis framework to solve accounting and reporting issues.

INTRODUCTION

Welcome to advanced accounting. We wish you a prosperous learning experience. We will study three major accounting topics: consolidations, foreign currency transactions and operations, and not-for-profit and government organizations. The topics are presented and illustrated in accordance with the generally accepted accounting principles (GAAP) that are expected to be in effect as of January 1, 2020, in Canada. You may have had some exposure to these topics in your previous accounting courses. We will build on this prior knowledge while we develop a thorough understanding of these selected topics.

Prior to 2008, the study of accounting principles in Canada focused on made-in-Canada accounting standards and involved very little, if any, thought or discussion of accounting standards in other parts of the world. Since then, Canada has adopted International Financial Reporting Standards (IFRS) for public companies and has separate sections in the *CPA Canada Handbook* for public companies, private companies, not-for-profit organizations, and pension plans.

The changes in reporting standards were due to the globalization of economic activity. Canadian companies now view the entire world as their marketplace. Not only are they exporting their products to more countries than ever before, they are also establishing factories and offices in foreign locations. Companies that used to raise capital strictly in their home countries are now finding that capital markets are available to them around the globe. Many accounting firms have offices throughout the world, and there are abundant opportunities for their Canadian staff members to transfer to these offices.

In this chapter, we will begin by reviewing the conceptual framework for financial reporting. We will then describe and apply a framework for analyzing financial reporting cases. We will close by analyzing the impact of different financial reporting methods on key ratios in a company's financial statements.

Canadian companies are now able to raise capital resources in the world's marketplace.

LO1 THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Professional accountants provide a variety of services ranging from accounting to tax planning to assurance to business consulting. In this course, we will focus on financial accounting—that is, providing general-purpose financial information to external users such as investors and creditors. These users typically have limited financial resources to invest in an entity. Users wish to invest where they can earn the highest return with the lowest amount of risk. The general-purpose set of financial statements (balance sheet, income statement, statement of changes in equity, cash flow statement, and notes to the financial statements) will be used by the external users to help them make their resource allocation decisions and to assess the stewardship of management. The general-purpose reports are not the only source of information used for making decisions but provide a good starting point.

In most cases, users want to receive the general-purpose financial statements prepared in accordance with generally accepted accounting principles (GAAP) because when these principles are followed the information is made relevant, reliable, understandable, and comparable. However, there are times when users may want or require special-purpose financial reports that do not follow GAAP. For example, entities may need to prepare non-GAAP-based statements for legislative or regulatory purposes, or for contract compliance. Or a prospective lender may want to receive a balance sheet with assets reported at fair value rather than historical cost. As accountants, we are able to provide financial information in a variety of formats or using a variety of accounting policies because we have the skills and abilities to produce this information. If we do provide fair-value-based financial statements, we cannot say that the statements were prepared in accordance with GAAP. We would simply state that the statements were prepared in accordance with the policies described in the notes to the financial statements.

Cautionary Note: The titles of the financial statements in International Accounting Standard (IAS) 1 are the recommended titles, but not mandatory. Many Canadian companies now use and will likely continue to use the titles balance sheet (rather than statement of financial position*) and income statement (rather than* statement of profit or loss*). In this textbook, we will use both sets of titles. We will also vary the ordering of assets, liabilities, and shareholders' equity. In some cases, current assets will appear first and shareholders' equity will appear last. In other cases, long-term assets will be followed by current assets and shareholders' equity will precede liabilities on the credit side of the statement of financial position. Both formats are acceptable under IAS 1. In the problems and illustrations that do not involve other comprehensive income (OCI), we will focus only on the statement of profit or loss (i.e., the income statement) rather than the statement of comprehensive income, and on preparing a statement of retained earnings rather than preparing a complete statement of changes in equity.*

GAAP encompasses broad principles and conventions of general application, as well as rules and procedures that determine accepted accounting practices at a particular time. The process of developing GAAP is political. Both preparers and users of financial statements have an opportunity to comment on a proposal for a new accounting standard before it becomes generally accepted. If a new requirement is preferred by the preparers but not accepted by users, it is unlikely to become part of GAAP. Therefore, as we study existing accounting practices and proposed changes, we need to continually evaluate whether information provided by a reporting entity will satisfy users' needs.

In most cases, the users of the financial statements have access to information about the entity in addition to that provided in the financial statements. For example, the owner of a private company may also be the manager and would have intimate knowledge of the company. In such cases, the owner/manager may place less reliance on the financial statements than outside investors in public companies do. In other situations, the owner may not understand the financial reporting for complex transactions such as business combinations. In both of these situations, the owners may feel that the costs of complying with some of the complex sections of the *Handbook* are not worth the benefit. They may prefer to issue more simplified statements. The Chartered Professional Accountants of Canada (CPA Canada) recognized this difference in users' needs. In 2011, the *Handbook* was reorganized and is now segregated into different parts for different types of organizations.

Financial statements should cater to the needs of the users.

The *CPA Canada Handbook* is an authoritative document in Canada because many legal statutes require its use. For example, companies incorporated under the Canada Business Corporations Act and certain provincial Companies Acts are required to prepare financial statements in accordance with the *CPA Canada Handbook*. Publicly traded companies are required to submit financial statements that comply with GAAP to the securities commissions under which they are registered.

The Handbook *is divided into different parts to cater to different types of reporting entities.*

The *CPA Canada Handbook* provides the accounting and reporting requirements as well as explanations and guidance for most transactions and events encountered by an entity. When an entity following IFRS encounters transactions or events not explicitly addressed by the standards, it should adopt accounting practices consistent with the spirit of the standards and consistent with financial statement concepts. These concepts are described in "The Conceptual Framework for Financial Reporting," a document found just prior to IFRS in Part I of the *Handbook*. Entities reporting under Accounting Standards for Private Enterprises (ASPE) should adopt accounting practices consistent with Section 1000, "Financial Statement Concepts" in Part II of the *Handbook*.

The *financial statement concepts* describe the principles and assumptions underlying the preparation of financial statements. They are very important parts of GAAP, because they provide the framework for the development and issuance of other financial accounting standards. The main items included in this document are as follows:

- The objective of general-purpose financial reporting
- Qualitative characteristics of useful financial information
- Underlying assumptions
- Definition, recognition, and measurement of the elements of financial statements

You will probably recognize most of the concepts and remember studying them in your intermediate accounting courses. If you can explain the accounting practices learned there in terms of these basic concepts, you should have no trouble applying these concepts in the new situations we will encounter in this course. If you do not understand or cannot explain accounting requirements in terms of these basic concepts, it is never too late. As you study the accounting requirements in this course, try to understand them in terms of the basic concepts and principles the *Handbook* describes.

All accounting practices should be traceable to and supported by the conceptual framework.

By gaining a broad understanding of the logic and basic principles behind the accounting requirements, you will develop confidence and be able to apply these basic principles in a wide variety of situations. Rather than simply accepting accounting practices or memorizing specific requirements in the *Handbook,* you will begin to understand the logic of the requirements and evaluate whether these are consistent with the basic financial statement concepts. You will soon realize that most of the requirements in accounting can be understood, developed, and derived from these basic principles and concepts. Then, in turn, you will be able to use professional judgment to apply these principles to whatever situation you may encounter.

Professional Judgment

Judgment is the ability to make a decision in situations in which the answer is not clear-cut. Professional judgment is the ability to make decisions about issues encountered by professionals in carrying out their day-to-day responsibilities. It is a skill developed over many years of studying and learning from experience. It is not learned by memorizing requirements or answers to certain problems. It often involves choices between meaningful alternatives and the ability to understand the consequences of our actions.

Lots of judgment is involved when preparing financial statements.

In the preparation of financial statements, judgment needs to be applied in three main areas.

First, accounting policies, such as when to recognize revenue and whether to consolidate a special-purpose entity, involve making a decision after considering various methods. The method adopted for a particular company must be appropriate for that company on the basis of its existing situation. For example, if Company A is selling to customers with poor credit histories and without obtaining security for the receivables from these customers, it is appropriate to recognize revenue when cash is received. If competitors are selling to customers with very high credit ratings, it is appropriate for them to recognize revenue when the goods are delivered. The professional judgment of an accountant will take these factors into consideration and recognize that although one method might be appropriate for the competitors, another might be more appropriate for Company A.

Second, judgment is involved in making accounting estimates of many kinds. What is the estimated useful life of property, plant, and equipment? What is the recoverable amount for goodwill? Will a forward contract be effective as a hedge of expected sales for the next three years? The answers to these questions are not clearly defined. In the classroom, we are usually provided with this information, but in the real world we must gather data and make our own assessments. Whether we feel that the company can continue as a going concern or not would likely have a material impact on the valuation of goodwill and the bottom line on the income statement.

Third, judgment is involved in deciding what to disclose and how to disclose it in the notes to the financial statements. For example, in disclosing a contingent liability resulting from a lawsuit, the company might simply say that it has been sued but no provision has been made in the financial statements because it feels that the lawsuit has no merit, or it might provide details of the lawsuit and give some probabilities of different outcomes in the note.

Judgment is involved when adopting accounting policies, making estimates, and writing the notes to the financial statements.

Is there too much latitude in accounting? Do the financial statements ever portray the complete facts? One could argue that there is no latitude because accountants are not free to randomly select any reporting method. They must represent faithfully what really happened and what really exists using the generally accepted conceptual framework. If the revenue has been earned, then the revenue should be recognized. If the expenditure will provide a future benefit, then the cost of the expenditure should be recognized as an asset. Latitude is necessary so that the accountant can choose the accounting treatment that reflects the real situation. If the requirements are written too rigidly, companies may be forced to use methods that do not reflect their own situations.

If accountants take their jobs seriously and have high ethical standards, they will present the financial statements as reliably as possible by using appropriate accounting policies, by making the best estimates possible, and by making honest and forthright statements in the notes to the financial statements. They will use judgment to fairly present the financial position and financial performance of the entity. Otherwise, the individual accountants and the entire accounting profession will lose credibility.

Financial statements should present what really happened during the period; that is, they should tell it how it is.

This course provides an opportunity to develop judgment skills and to exercise judgment through the use of cases. The cases provide realistic scenarios where conflicts exist and choices must be made. As we have indicated, the answers are not usually clear-cut. In fact, different valid answers can be defended. For these cases, it is how you support your recommendation that is important, as opposed to what your final recommendation is. You will need to apply basic principles and use judgment to come up with an answer that "tells it how it is" as accurately as possible. In so doing, you will be developing the skills required of a professional accountant. See Appendix 1A for a discussion and illustration of a generic approach for analyzing and solving a case with issues in the domain of the aspiring accountant.

LO2 ACCOUNTING STANDARDS IN CANADA

The *CPA Canada Handbook* contains five parts:

Part #	*Applicable to*	*Name for Standards*
I	Publicly accountable entities	IFRS
II	Private enterprises	ASPE
III	Not-for-profit organizations	
IV	Pension plans	
V	All entities not yet using other parts	Pre-changeover GAAP

The next few sections describe a bit of the history behind the development of different standards for different entities and the choices available for these entities in applying the different parts of the *CPA Canada Handbook*.

GAAP FOR PUBLICLY ACCOUNTABLE ENTERPRISES Public companies seemed to be moving toward American accounting standards when, in 1998, CPA Canada announced that it would work with the Financial Accounting Standards Board (FASB) to harmonize the accounting standards of the United States and Canada, at the same time encouraging the International Accounting Standards Board (IASB) in its efforts to develop global accounting standards.

Harmonization would probably have been difficult, because Canadian accounting standards tend to be broad-based while American standards tend to be based on detailed rules. This problem was alleviated in 2006 when CPA Canada announced the adoption of a strategic plan that would see the harmonization of the *CPA Canada Handbook* with IFRS for *publicly accountable enterprises.* A publicly accountable enterprise (PAE) is defined as an entity other than a not-for-profit organization or a government or another entity in the public sector that

At one time, Canada intended to harmonize its standards with those of the United States.

(i) has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market (a domestic or foreign stock exchange, or an over-the-counter market, including local and regional markets), or

(ii) holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

Banks, credit unions, insurance companies, securities brokers or dealers, mutual funds, and investment banks typically meet the second of these criteria. Other entities may also hold assets in a fiduciary capacity for a broad group of outsiders, because they hold and manage financial resources entrusted to them by clients, customers, or members not involved in the management of the entity. However, if an entity does so for reasons incidental to one of its primary businesses (as, for example, may be the case for some travel or real estate agents, or cooperative enterprises requiring a nominal membership deposit), it is not considered publicly accountable.

Canadian publicly accountable enterprises have to report under IFRS.

Harmonization was chosen instead of simply adopting the international standards because security regulations as well as federal and provincial Companies Acts require financial reporting to be in accordance with Canadian GAAP. Because of this requirement, Part I of the *CPA Canada Handbook* now contains standards that are the same as IFRS. Rather than always referring to Part I of the *Handbook,* we will simply refer to IFRS. Commencing in 2011, Canadian publicly accountable enterprises had to report under IFRS.

The IFRS were quite similar to Canadian standards prior to the adoption of the international standards, because they are based on similar conceptual frameworks and reach similar conclusions. However, there were many differences in the detailed requirements. IFRS often allow for optional treatments and, in some instances, allow or require the use of fair values in financial statement measurements, whereas Canadian standards did not often allow optional treatments and tended to require more historical cost measurements.

IFRS allows the use of fair values and optional treatments to a greater degree than pre-changeover Canadian GAAP (Part V of the CPA Canada Handbook*).*

GAAP FOR PRIVATE ENTERPRISES In the 1970s there was considerable discussion in Canada of Big GAAP versus Little GAAP. The question was: Should there be different standards for big companies and little companies?

It was argued that accounting standards were becoming increasingly complex and that a small company's costs in preparing its financial statements to comply with the standards were greater than the benefits received by the users of such statements. Hence, it was suggested that small companies should be granted some sort of relief from having to use complex and hard-to-understand standards. Counterarguments suggested that fair presentation and comparability could not be achieved with different sets of standards, and the dividing line between big and small would be too arbitrary to be useful. After much study and discussion, the concept of Big GAAP/Little GAAP was abandoned.

Cautionary Note: Unless otherwise stated, assume that IFRS should be applied when answering end-of-chapter material.

In the meantime, the issuance of new, complex financial reporting standards continued, and the last straw, so to speak, was the issuance, in the early 1990s, of both the section on presentation and disclosure of financial instruments and the exposure draft on the related measurement issues. The issue of different standards was revisited by a CPA Canada task force, but this time in relation to public versus non-public companies. The task force considered two basic approaches:

The cost–benefit constraint is used when determining whether a private enterprise can use simpler reporting methods.

1. A non-GAAP approach whereby non-public companies could use accounting policies completely separate from GAAP. An example is the use of cash-basis reporting instead of the required accrual basis. This approach was abandoned mainly because provincial and federal Companies Acts require companies to prepare financial statements in accordance with the *CPA Canada Handbook*.
2. A GAAP approach that was looked at from two perspectives: full differentiation and partial differentiation. Full differentiation would encompass two distinct sets of GAAP, somewhat similar to the accounting for

non-profit organizations and governments (discussed in Chapter 12). Partial differentiation encompasses one set of accounting standards with different treatments. This latter approach was adopted in 2002 when Section 1300, "Differential Reporting," was issued and certain sections of the *CPA Canada Handbook* were amended to allow optional treatments.

Companies were following GAAP when they adopted differential reporting options.

Section 1300 allowed a qualifying enterprise to select which reporting options it would apply when it prepared its financial statements. The differential reporting options allowed were contained in individual *Handbook* sections, and only a few sections contained such options.

Section 1300 was a part of the *Handbook* and was considered a primary source for information about GAAP. When a company adopted one or more of the differential reporting options, it was still considered to be following GAAP.

In 2006, when the decision was made by the Accounting Standards Board (AcSB) to adopt IFRS for publicly accountable enterprises commencing in 2011, a CPA Canada task force was established to revisit the question of what standards should be applied to private companies. The task force considered three different approaches:

1. A non-GAAP approach, whereby private companies could use a more simplified method of reporting than that required under differential reporting
2. A GAAP approach based on requirements being developed by IASB for small and medium-sized enterprises
3. A GAAP approach based on developing a separate part of the *CPA Canada Handbook* dedicated solely to private enterprises

Part II of the CPA Canada Handbook *contains GAAP for private enterprises.*

After much discussion and input from interested stakeholders, in 2009 the Canadian AcSB chose the third approach. These standards are included in Part II of the *Handbook* and are referred to as Accounting Standards for Private Enterprises (ASPE). A private enterprise is defined as a profit-oriented enterprise that

(a) has not issued, and is not in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market (a domestic or foreign stock exchange, or an over-the-counter market, including local and regional markets), and

(b) does not hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

The standards are available to any private enterprise. No size threshold or other barrier, such as unanimous consent by shareholders or other users, is imposed. The standards stand alone (i.e., private enterprises applying them are not required to refer to standards applicable to publicly accountable enterprises).

Private enterprises can report under either IFRS or ASPE.

Private enterprises may adopt either ASPE (Part II) or IFRS (Part I). Whichever set of standards is adopted, it must be the whole package. It is not possible to apply certain standards from ASPE and others from IFRS.

Some private companies may choose to follow IFRS for the following reasons:

- The company may be of a similar size to certain public companies, and the users of its financial statements may insist on IFRS so that the company can be compared with those public companies.
- The company may be planning to go public in the near future.
- A parent company uses IFRS.

LO3 Exhibit 1.1 lists some of differences between IFRS and ASPE in topics discussed in intermediate accounting.

EXHIBIT 1.1

Some Key Differences between IFRS and ASPE

Accounting Item	*IFRS*	*ASPE*
Disclosure	Very extensive for many items, especially financial instruments, post-employment benefits, and segment reporting	Moderate for financial instruments and post-employment benefits, and no disclosure for segments
Impaired loans receivable	Discount future cash flows using original discount rate	Discount future cash flows using current rate of interest
Property, plant, and equipment		
Revaluation option	Can be revalued to fair value with adjustment to OCI and with depreciation based on revalued amount	Must be measured at cost less accumulated depreciation
Asset impairment		
Test for impairment if indicator requires	Asset's carrying amount exceeds the higher of its (1) value in use (discounted expected future cash flows) and (2) fair value less costs of disposal	Asset's carrying amount exceeds the undiscounted expected future cash flows from the asset. If so, write asset down to lower of carrying amount and fair value.
Subsequent reversal of impairment loss	Required if indicators change	Not allowed
Development costs	Capitalize if certain criteria are met	Capitalize, if criteria met, otherwise expense
Post-employment benefits		
Actuarial gains/losses	Recognize immediately in OCI	Recognize immediately in net income
Income taxes	Set up deferred income taxes as applicable	Choose between taxes payable or future income tax methods
Interest capitalization	Capitalize if certain criteria are met	Choose between capitalizing or expensing
Compound financial instrument	Allocate between debt and equity	Can choose to allocate a nominal amount to equity
Preferred shares in tax planning arrangement	Assess whether debt or equity	Record as equity unless redemption demanded
Value of conversion option for convertible bonds	Record as equity	Choose between recognizing as debt or equity
Lease accounting by lessee	Record lease of greater than 12 months as asset and liability	Record lease as asset and liability if substantially all benefits and risks are transferred to lessee

For the next ten chapters, we will concentrate on IFRS throughout the main body of each chapter. At the end of each chapter, we will summarize the main differences in the standards for private enterprises as compared with the standards for publicly accountable enterprises for the topics considered in that chapter.

ASPE sometimes allow a choice between different reporting methods.

GAAP FOR NOT-FOR-PROFIT ORGANIZATIONS Prior to segmentation of the *CPA Canada Handbook* into five parts, the *Handbook* had a series of sections, the 4400 series, dedicated to not-for-profit organizations (NFPOs). Many of the other *Handbook* sections were also applicable to NFPOs. With the adoption of IFRS for public companies and ASPE for private enterprises, a decision had to be made on how to service the NFPOs.

In December 2008, the AcSB and the Public Sector Accounting Board (PSAB) jointly issued an Invitation to Comment, *Financial Reporting by Not-for-Profit Organizations*. In December 2010, the final standards for NFPOs were released. As part of this process, the not-for-profit (NFP) sector was divided in two: the government NFP sector and the non-government NFP sector. The government NFP sector includes NFPOs that are controlled by the government. They have a choice to follow either the 4200 series of the CPA Canada *Public Sector Accounting (PSA) Handbook* or the *PSA Handbook* without the 4200 series. The non-government NFP sector includes NFPOs not controlled by the government. They have a choice to follow either IFRS (which do not currently contain any standards specifically tailored for NFPOs) or Part III of the *CPA Canada Handbook*. An NFPO applying Part III of the *Handbook* also applies the standards for private enterprises in Part II, to the extent that the Part II standards address topics not addressed in Part III.

Part III carries forward the 4400 series of sections from the pre-changeover *Handbook*, largely without change. Five new sections were added. They contain relevant material from Part II that the AcSB deemed necessary to clarify their applicability to NFPOs.

Non-government NFPOs can report under either IFRS or Part III of the CPA Canada Handbook, *combined with relevant sections from Part II of the* Handbook.

The accounting standards for NFPOs will be discussed and illustrated in Chapter 12.

GAAP FOR GOVERNMENT AND OTHER GOVERNMENT ORGANIZATIONS All levels of government should follow the *PSA Handbook*. Government business enterprises are expected to follow IFRS. Other government organizations can follow either IFRS or the *PSA Handbook*. The accounting standards for government entities are summarized in Appendix C of Chapter 12.

The following table summarizes the standards required or allowed for different types of Canadian organizations:

Type of Organization	*Standards Required or Allowed*
Publicly accountable organization	IFRS (Part I)
Private enterprise	IFRS (Part I) or ASPE (Part II)
Non-governmental NFPO	IFRS (Part I) or Standards for NFPOs (Part III)
Governmental NFPO	*PSA Handbook* with or without 4200 series
Government	*PSA Handbook*
Government business enterprise	IFRS (Part I)
Other government organization	IFRS (Part I) or *PSA Handbook*
Pension plan	Standards for Pension Plans (Part IV)

By using the above-noted standards, the organization is considered to be following GAAP. In choosing between the various options, the organization would consider the needs of the users of their financial statements and the comparability of the organization with counterparts in the private or the public sector. In the notes to the financial statements, the set of standards being used should be explicitly stated.

The entity should specify in the notes to the financial statements the part of the Handbook *being used for reporting purposes.*

LO4 ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

We have seen many examples in this chapter of differences in accounting and reporting practices. The CPA Canada *Public Sector Accounting (PSA) Handbook* is different from Parts I, II, or III of the *CPA Canada Handbook*. With all of these differences, is there an opportunity for a company to manipulate its financial statements by choosing policies to produce desirable results? Do financial analysts know that these choices exist in accounting? Do they understand the impact of the different accounting methods on the financial statements?