Invitation to Comment

Accounting Standards in Canada: Future Directions
Draft Strategic Plan

prepared by:
Accounting Standards Board

Comments are requested by July 31, 2005

AcSB

Accounting Standards Board
AcSB CNC Conseil des normes comptables

Responding to this Invitation to Comment

This Invitation to Comment is issued by the Accounting Standards Board. The Board is composed of persons knowledgeable in the preparation and use of financial statements with backgrounds in business, public practice and academe. All members serve as individuals and not as representatives of their employers or organizations.

Individuals and organizations are invited to send written comments to the Board. Comments are most helpful if they clearly explain the issues they raise and suggest a specific course of action supported by specific reasoning. All comments received will be available on a public file within one week of receipt.

To be considered, comments must be received by July 31, 2005, addressed to:

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

For ease of handling, we prefer comments to be sent by e-mail (in Word format), to:
ed.accounting@cica.ca

ACCOUNTING STANDARDS IN CANADA: FUTURE DIRECTIONS DRAFT STRATEGIC PLAN INVITATION TO COMMENT

Highlights

The Accounting Standards Board proposes, subject to comments received following exposure, to adopt a new five-year strategic plan for the period 2006-2011. This draft strategic plan outlines the broad policy objectives that will guide the Board in carrying out its standard-setting mandate.

In summary, the Board proposes the following strategies for financial reporting in Canada:

- The Board will pursue separate strategies for the major categories of reporting entities (public companies, private businesses and not-for-profit organizations). The Board recognizes that "one size does not necessarily fit all"; it is not possible to address the divergent needs of different categories of reporting entities properly within a single strategy. Each category deserves a strategy that specifically addresses the particular needs of the users of financial statements of entities in that category.

- For public companies:

  The Board will direct its efforts primarily to participating in the movement toward the global convergence of accounting standards. The best way to achieve the objective of a single set of globally accepted, high-quality accounting standards is to converge Canadian GAAP with International Financial Reporting Standards (IFRSs) over a transitional period, expected to be five years. At the end of that period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies.

  To achieve convergence, the Board will:

    - amend or replace individual Canadian standards to conform to corresponding IFRSs, and adopt newly developed IFRSs;

- work with both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to ensure that the Canadian perspective is taken into account in the deliberations of those bodies; and
- work to promote the further convergence of IASB and FASB standards.

In taking on a role in the development of global standards, the Board will cease to make final decisions on most matters affecting the technical content and timing of implementation of standards applied in Canada.

Full convergence with IFRSs will be achieved by the changeover date at the end of the transitional period. The Board believes that by providing ample lead time and a clear transition plan, the costs and disruption to affected stakeholders will be less than the alternative of a gradual, extended phase-in approach with multiple successive accounting changes. The Board may consider giving companies the ability to adopt individual converged standards during the transitional period as they are introduced into the CICA Handbook – Accounting to replace current standards.

The Board will review progress in implementing its strategy after the first 24-30 months. The Board will assess whether there have been significant changes in any of the environmental factors that have influenced the development of the strategy, without necessarily undertaking further public consultations. The plan will be assessed in particular against progress in the development of IFRSs and their acceptance globally. Assuming that the Board's review confirms the suitability of IFRSs as a basis for public company financial reporting in Canada, the Board will set the definitive changeover date when Canadian GAAP for public companies will be fully converged with IFRSs.

The Board acknowledges that US GAAP has been determined by the competent authorities to be an appropriate alternative basis of financial reporting for certain public companies. Public companies would continue to be in a position to adopt US GAAP, in place of IFRSs, on the basis decided by lawmakers and regulators.

- For private businesses:

  The Board will undertake a comprehensive examination of the needs of the users of these businesses' financial statements and then determine the most appropriate financial reporting model to meet those needs. This will require research to identify more clearly who the financial statement users are, what their information needs are and what reporting model or models might best satisfy those needs. The Board has no preconceived idea of the outcome of this process, but notes that the possibilities include both a set of standards not very different from current standards and a set of standards that is substantially different from current standards.

  The proposed research may be conditional on obtaining additional resources and will take some time to complete, during which the current differential reporting model will remain in place. Currently existing differential reporting alternatives will be maintained, and any additional alternatives will be developed through the current process with the advice of the Board's Differential Reporting Advisory Committee.

  The Board will clarify that GAAP requirements are intended to apply only to entities that have significant external users of financial information and require the application of a common basis of financial reporting. The Board will take steps to limit the scope of its standards to such entities, thereby exempting a number of smaller private businesses that do not need GAAP financial statements.

- For not-for-profit organizations:

  Not-for-profit organizations (NFPOs) will continue to apply those elements of GAAP for profit-oriented enterprises that are applicable also to the circumstances of NFPOs. The Board will consult with the not-for-profit sector to determine whether all NFPOs should base their accounting on the standards for public companies, or whether some might base their accounting on the standards for Canadian private businesses or be exempted from the scope of accounting standards altogether.

The Board will continue its current practice of developing standards that deal with the special circumstances of NFPOs, and will focus more of its attention on addressing those circumstances.

- Canada will continue to maintain its own standard-setting capability to carry out the strategies outlined above, although the roles, structures, processes and resources will evolve to match those strategies.

A more complete description of these strategies, together with the Board's reasons for proposing them, is set out below (Appendix B summarizes which standards will apply to which entities).

The Board's proposed plan also includes the following commitment:

- In carrying out these strategies, the Board proposes to pay particular attention to the practical limitations on the ability of the Canadian financial reporting system to cope with change. In other words, the Board will be particularly sensitive to the "standards overload" issue. Where change is determined to be necessary, the Board will take such steps as it can to assist affected parties in dealing with change through, for example, participating in the development of implementation aids and training programs.

If adopted, the proposed strategies will require the development of more detailed implementation plans that are not included in this Invitation to Comment. At this stage, the Board is seeking the views of interested parties on the general directions it proposes to adopt, as a basis for confirming or varying those proposals. The more detailed descriptions of the strategies in the draft plan include some discussion of key implementation issues that the Board has identified, although not a specific work program.

The Auditing and Assurance Standards Board (AASB) is undertaking the development of new strategies that respond to some of the same developments addressed by this draft plan. The Board will take into account the AASB's findings and proposals that are relevant to the strategic directions proposed by the Board. The Board will also work with the AASB and the Public Sector Accounting Board in resolving financial reporting issues it has in common with either or both of those boards.

Process and timing for the Board's planning process

On the basis of this Invitation to Comment, the Board intends to obtain input on its proposed strategies through comment letters and a series of direct consultations with interested parties during the period up to the comment deadline. After analyzing the input received, the Board will develop any necessary modifications to the draft plan and review the revised draft plan with the Accounting Standards Oversight Council (AcSOC). The Board expects to finalize and publish its plan in the first quarter of 2006, and begin implementing it on April 1, 2006, the beginning of its next operating year.

Comments requested

The Board welcomes comments on all aspects of its draft strategic plan. Comments are most helpful when they indicate the specific strategy to which they relate, clearly explain the problem or concern and provide a suggested alternative strategy with supporting reasoning.

The Board is particularly interested in obtaining comments on the overall suitability of the proposed strategies, including:

- whether it is appropriate to apply different strategies to different major categories of reporting entities, rather than to apply the same strategy to all;
- whether the strategy for each of the major categories of entities establishes an appropriate direction for the future development of financial reporting requirements for the entities to which it applies (that is, whether the strategies will create an improvement in Canadian financial reporting, and the benefits will exceed the associated costs); and
- whether the individual strategies and the plan as a whole are operational (that is, whether it appears likely that they could be carried out as described within the proposed timeframes without causing undue disruption to affected parties).

While the Board has explicitly invited comment on only one specific issue discussed in the draft plan — the approach to transition for public companies described in paragraphs 45-46 — it is interested in comments on other such matters that are important to the application of the strategies.

Written comments are requested by July 31, 2005. Comments may be conveyed to the Board orally through meetings to be arranged during the comment period.

Draft Strategic Plan

Table of Contents

Introduction

1 This section of the Invitation to Comment sets out details of the strategies proposed by the Board and the reasons for adopting those strategies and rejecting others. The draft plan does not include a work program specifying projects for developing individual accounting standards, nor detailed steps for carrying out each of the strategies described. A work program and related details will be developed following approval of the Board's strategies.

Background

2 In March 2004, the Board began a review of its current strategies for setting Canadian accounting standards. The Board issued an Invitation to Comment in May 2004 seeking public input on several key issues. An accompanying Discussion Paper outlined the Board's current strategies, the reasons for the Board to undertake a fundamental re-evaluation of those strategies and the significant factors having a bearing on those strategies.[1]

3 The 2004 Discussion Paper noted that there had been some significant changes in the standard-setting environment since the Board had last reviewed its strategies and policies. These changes include:

(a) an increasing stratification of the universe of Canadian reporting entities;

(b) changes in the standard-setting climate as a result of recent financial reporting failures internationally, including greater emphasis on principle-based standards and more concern with the extent of rule-based requirements in US GAAP;

(c) the increasing trend to global convergence of accounting standards, and the emergence of International Financial Reporting Standards (IFRSs) as a viable basis for achieving convergence through an international partnership of standard setters;

(d) the increasing extent of harmonization of Canadian GAAP and US GAAP, and the difficulties created for Canadian financial statement preparers and auditors by importing certain aspects of US GAAP;

(e) legal changes adopted or proposed permitting certain public companies to adopt US GAAP for some Canadian financial reporting purposes;

(f) the pace of change and the extent to which financial statement preparers, auditors and users are overloaded by the accumulated burden of new accounting, disclosure, auditing, governance and other requirements; and

---

[1] The May 2004 Invitation to Comment, *Accounting Standards in Canada: Future Directions*, and related Discussion Paper, together with additional background information, are available on the Board's website at www.acsbcanada.org.

(g) questions about whether accounting standards meet the financial reporting needs of all categories of reporting entity, even with the introduction of differential reporting for certain non-publicly accountable enterprises.

Refer to the Discussion Paper for detailed discussion of these issues.

4 The 2004 Invitation to Comment questioned whether Canada should:

(a) maintain its own standard-setting capability;

(b) maintain its own GAAP or adopt either US GAAP or IFRSs;

(c) maintain the current strategies of working to support the international convergence of accounting standards while harmonizing with US GAAP (giving precedence to the latter); and

(d) consider modifying current GAAP requirements to provide better information to the users of financial statements of various different types of entities through, for example, a wider application of differential reporting.

The 2004 Invitation to Comment identified several possible scenarios and their more significant potential effects.

5 The Board received 68 letters of comment on the 2004 Invitation to Comment, many of which presented collective views from large organizations. In addition, 106 individuals attended public roundtable meetings held by the Board to solicit oral comments. A number of these individuals expressed views on behalf of others. Board representatives met privately with certain key stakeholder groups, including the Board's User Advisory Council, to brief them and discuss issues raised by the 2004 Invitation to Comment. The input received reflected views from financial statement users, preparers and auditors as well as from academe and regulators. All of this input was discussed with the Accounting Standards Oversight Council (AcSOC) at its October 21-22, 2004 meeting, in a public session.[2]

[2] The comment letters and a summary of comments made in public roundtable meetings are available on the Board's website (www.acsbcanada.org).

6 The Board received a wide range of views on the principal issues. Commentators did not take issue in any significant way with the Board's assessment of the standard-setting environment laid out in the Discussion Paper, or with the need to reconsider the current strategies. While some commentators were comfortable with the status quo, at least in the short to medium term, most favoured change. This proposed strategic plan reflects what the Board believes will best serve the public interest. In light of the responses to the 2004 Invitation to Comment, the Board believes the proposals strike an appropriate balance among the competing legitimate needs of its stakeholders and will receive broad-based support. For public companies, the proposals represent in large measure an acceleration of the ultimate objective of the current strategic plan — global convergence — while acknowledging the needs of those who have advocated the other key component of the current plan — harmonization with US GAAP. For private businesses, the proposals provide a basis for resolving current concerns that standards do not address the financial reporting needs of that sector. For not-for-profit organizations, the proposals offer continued attention to issues unique to that sector as well as relief for smaller organizations comparable to that offered to smaller private businesses. The principal purpose of this Invitation to Comment is to test whether the Board has struck the right balance in response to commentators' views.

"One size does not necessarily fit all"

7 The first of the strategies proposed by the Board is the following:

> The Board will pursue separate strategies for the major categories of reporting entities (public companies, private businesses and not-for-profit organizations). The Board recognizes that "one size does not necessarily fit all"; it is not possible to address the divergent needs of different categories of reporting entities properly within a single strategy. Each category deserves a strategy that specifically addresses the particular needs of the users of financial statements of entities in that category.

8 The Discussion Paper and related background information accompanying the 2004 Invitation to Comment dwelt at some length on the fact that the universe of Canadian

reporting entities is quite diverse and stratified into several distinct sectors with differing financial reporting needs. The responses to the 2004 Invitation to Comment confirmed the existence of that stratification and its significance. The approximately 4,000 Canadian public companies represent a small fraction of one percent of all reporting entities by number but about half of the business activity in the country. The several hundred Canadian public companies active in equity capital markets outside Canada represent only about ten percent of all Canadian public companies but a significant proportion of business activity within the public company sector. The private business sector represents about half of the business activity in the country but a great many more reporting entities. On average, private businesses are much smaller than public companies. Not-for-profit organizations comprise another significant sector containing entities varying widely in size and nature but all with a somewhat different focus to their financial reporting.

9 Each of these sectors has quite different financial reporting needs and concerns. For example, some of the largest Canadian public companies, most of which are active in US capital markets, want to apply US GAAP in place of Canadian GAAP. Most other reporting entities have little or no interest in US GAAP and generally find it burdensome if not also unresponsive to their needs. There may be no need for accounting standards to deal with the rudimentary financial reporting needs of some very small, owner-managed entities. The needs and concerns of the various sectors are discussed in more detail below.

10 Trying to be “all things to all people” in a single set of accounting standards could result in serving no one adequately. Accordingly, the Board has concluded that it will consider whether it is necessary to have separate bases of financial reporting for various major groups of reporting entities. The proposed groups reflect the characteristics of the users and the uses of financial statements in each sector. The Board believes that by focusing on the particular needs of the sector for which each basis of financial reporting is designed, the result will be financial information that is more useful to that sector. The Board has reached no conclusions on whether the various bases of financial reporting need to differ from each other and, if so, how they should differ. However, the intention

is that differences will be minimized wherever possible and all financial reporting standards will be based on the same conceptual framework.

11 The Board recognizes that many Canadians retain some attachment to the idea of a single set of GAAP that can somehow accommodate all reporting entities at a high level, but that also provides for some differentiation of requirements for various sectors. This can be seen, in particular, in the proposal in some of the responses to the 2004 Invitation to Comment that Canadian standards be restructured into a "core GAAP" that would apply to all reporting entities and "enhanced GAAP" requirements that could be layered onto the core requirements to satisfy the additional needs of public companies. Such an approach seems readily applicable to disclosure items and possibly modified versions of some measurement requirements. However, some of the elements that have been suggested for "core GAAP" conflict with requirements appropriate for "enhanced GAAP" for public companies. For example:

(a) fair value measurements required for certain assets and liabilities of public companies would conflict with historical cost measurements that might be required by "core GAAP"; and

(b) similarly, if "core GAAP" were to require the amortization of goodwill, it would conflict with the public company requirement to apply annual impairment testing but not to amortize goodwill.[3]

Based on the views expressed, the Board has concluded that it is not realistic to expect that the concerns of those who are dissatisfied with the current differential reporting model can be addressed within the constraints of a "core GAAP plus enhanced GAAP" approach.[4]

---

[3] Both of the treatments suggested as components of "core GAAP" in these examples have been proposed by commentators from the small business sector. Further examples not cited here involve some recognition issues as well as measurement issues.

[4] This view of the concept of "core GAAP plus enhanced GAAP" is not a dismissal of the concerns of those in the private business sector who proposed that concept in responding to the 2004 Invitation to Comment. The Board essentially accepts their diagnosis of the problem (see the further discussion of the private business sector below), but not the proposed solution.

12 Some consider that two or more sets of accounting standards should not coexist within a single jurisdiction.[5] They are concerned about a lack of comparability among reporting entities and the burden placed on financial statement users, preparers and auditors of having to be familiar with more than one set of standards. They believe that the credibility of financial reporting is undermined when different companies report similar transactions in different ways.

13 Entities in the different sectors are often not compared with each other because the entities are too dissimilar or the information is not available widely to permit comparisons to be made. On the other hand, within the public company sector, companies that raise capital or trade in foreign markets are commonly compared with their competitors from other countries that apply different standards. The Board has heard from members of its User Advisory Council that some sets of accounting standards, notably Canadian GAAP and US GAAP, are sufficiently similar that financial statement users cannot distinguish them from each other or do not find it worth the effort to understand and analyze the differences. Some research findings indicate that the differences between Canadian GAAP and US GAAP financial statement amounts of companies that report both have no identifiable effect on the price of those companies' shares.[6] Those differences are not "value-relevant" and, accordingly, must be considered immaterial to investors. To a limited extent, different sets of standards have been in use

---

[5] For example, public companies in the United Kingdom have begun to apply IFRSs in 2005 in accordance with European Union requirements, while the UK government provides other companies with a choice of continuing to apply current UK standards. However, the UK Accounting Standards Board has concluded that there is no case to be made in favour of the UK continuing to have two wholly different sets of standards in the medium term. This issue is more fully discussed in the UK Accounting Standards Board's March 2004 Discussion Paper, *UK Accounting Standards: A Strategy for Convergence with IFRS*. Relative to this issue see also the discussion in footnote 7.

[6] See, for example, the papers by S. Bandyopadhyay, J. Hanna and G. Richardson, "Capital market effects of US/Canada GAAP differences" in *Journal of Accounting Research*, vol. 32, no. 2 (Autumn 1994), pp. 262-277; Mary E. Barth and Greg Clinch, "International Accounting Differences and Their Relation to Share Prices: Evidence from U.K., Australian, and Canadian Firms" in *Contemporary Accounting Research*, vol. 13, no. 1 (Spring 1996), pp. 135-170; and S. Bandyopadhyay, A. S. Hilton and G. D. Richardson, "A re-examination of reconciling items between Canadian and United States GAAP" in *Managerial Finance*, vol. 28, no. 3 (March 2002), pp. 37-56.

in Canada for some time without any indication that significant difficulties have resulted.[7] What financial statement users are most concerned about is whether the information they receive is relevant and reliable for their purposes. It appears that, after a certain degree of comparability between companies has been achieved, efforts to achieve greater comparability may not be worthwhile as the law of diminishing returns takes effect.

14 These factors and the Board's experiences in setting standards within its current strategies have convinced the Board that it is no longer appropriate to address the needs and concerns of all stakeholders in the Canadian financial reporting system through a single set of standards. This appears to hold true even with the variations currently provided or proposed to satisfy the differing needs of the different sectors. Having reached this conclusion, the Board then considered what different strategies might satisfy the needs and concerns of stakeholders in the different sectors, and whether it could develop a package of separate strategies that responds in a practical way to the input it has received.

Public companies

15 The Board's strategy for the public company sector is as follows:

(a) The Board will direct its efforts primarily to participating in the movement toward the global convergence of accounting standards. The best way to achieve the objective of a single set of globally accepted, high-quality accounting standards is to converge Canadian GAAP with IFRSs over a transitional period, expected to be five years. At the end of that period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies.

---

[7] Relative to this issue, it should be noted that some Canadian public companies have adopted US GAAP as their primary basis of financial reporting to their investors and creditors as a result of requirements of the US Securities and Exchange Commission (SEC). Both Canadian GAAP and US GAAP are accepted by Canadian users of public companies' financial statements. Certain Canadian subsidiaries of foreign parents report to their parent using the parent's basis of accounting and may also use the same information for reporting to creditors and others (usually a limited class of financial statement users). Some may go so far as to consider that the differential reporting alternatives available to qualifying enterprises and the separate requirements for not-for-profit organizations that are currently available in Canadian GAAP to be "different sets of standards".

(b) To achieve convergence, the Board will:

- amend or replace individual Canadian standards to conform to corresponding IFRSs and adopt newly developed IFRSs;
- work with both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to ensure that the Canadian perspective is taken into account in the deliberations of those bodies; and
- work to promote the further convergence of IASB and FASB standards.

In taking on a role in the development of global standards, the Board will cease to make final decisions on most matters affecting the technical content and timing of implementation of standards applied in Canada.

(c) Full convergence with IFRSs will be achieved by the changeover date at the end of the transitional period. The Board believes that by providing ample lead time and a clear transition plan, the costs and disruption to affected stakeholders will be less than the alternative of a gradual, extended phase-in approach with multiple successive changes. The Board may consider giving companies the ability to adopt individual converged standards during the transitional period as they are introduced into the CICA Handbook – Accounting (the Handbook) to replace current standards.

(d) The Board will review progress in implementing its strategy after the first 24-30 months. The Board will assess whether there have been significant changes in any of the environmental factors that have influenced the development of the strategy, without necessarily undertaking further public consultations. The plan will be assessed in particular against progress in the development of IFRSs and their acceptance globally. Assuming that the Board's review confirms the suitability of IFRSs as a basis for public company financial reporting in Canada, the Board will set the definitive changeover date when Canadian GAAP for public companies will be fully converged with IFRSs.

(e) The Board acknowledges that US GAAP has been determined by the competent authorities to be an appropriate alternative basis of financial reporting for certain public companies. Public companies would continue to be in a position to adopt US GAAP, in place of IFRSs, on the basis decided by lawmakers and regulators.

16 This strategy and the discussion that follows are framed in the context of "public companies" but, subject to further consideration in carrying out the strategy, will likely be extended to encompass "publicly accountable enterprises" as determined substantially in accordance with DIFFERENTIAL REPORTING, Section 1300 of the Handbook.

Moving on from the current strategies

17 The Board's current principal strategies[8] are to develop Canadian GAAP by:

(a) harmonizing with US accounting standards; and

(b) converging with a single set of globally accepted, high-quality international accounting standards.

The first objective is construed to mean the elimination of significant unjustifiable differences with US standards, but not the copying of all elements of US GAAP or even all elements of a particular US standard. It involves developing standards that do not conflict with US GAAP, but may also permit entities to adopt non-US GAAP accounting policies in some circumstances. The second objective means the adoption of the highest quality of US and international standards by working with the FASB, the IASB and other standard setters to agree on improvements to existing standards and the development of new standards. To the extent that it is clear that a current US standard is not of sufficiently high quality, the Board pursues the convergence objective.

18 Some respondents to the 2004 Invitation to Comment favoured the continuation of the current strategies in developing standards for public companies, perhaps with some change in emphasis. Some of those respondents wanted to bring Canadian GAAP even

---

[8] The current strategies were developed by the CICA Task Force on Standard Setting (TFOSS) in the period 1996-1998, as discussed briefly in the Discussion Paper, *Accounting Standards in Canada: Future Directions*. See also the extracts from the TFOSS Final Report in the background information accompanying the Discussion Paper.

closer to US GAAP than it is currently, but a majority of them preferred placing greater weight on international convergence.

19 Although few respondents to the 2004 Invitation to Comment seemed to feel that the current strategies have been inappropriate for public companies over the period since their adoption, the majority opinion is that circumstances have changed sufficiently that it is time for the Board to move on to different strategies. Commentators pointed to various factors outlined in the Discussion Paper in support of their views, but several factors stand out:

(a) Under the newly refined definition of Canadian GAAP in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 of the Handbook, some are confused over the extent to which companies should refer to, and adopt, detailed US requirements when applying Canadian GAAP. The Board has made carefully considered decisions about omitting from harmonized standards some US GAAP material that it considers overly prescriptive or detailed, with a view to permitting but not requiring adherence to such requirements under Canadian GAAP. Despite the Board's stated intent and the language of Section 1100, some feel that companies must look to US requirements that have not been reproduced in harmonized Canadian standards.

(b) Attempts to "Canadianize" standards developed by others are considered to be a wasteful use of standard-setting resources that also leads to confusion among financial statement preparers and auditors. Changes have generally been made to conform FASB or IASB standards to the Handbook. Such changes include the adoption of Canadian terminology and drafting style, and modifications to make the standard consistent with other elements of Canadian GAAP. The changes often lead to questions about whether the Board intended some difference between the original FASB or IASB standard and the harmonized Canadian equivalent.

(c) There is no need for "made-in-Canada" standards because experience over many years indicates that there are very few unique Canadian circumstances. A separate set of Canadian GAAP for public companies is unnecessary and inappropriate in the global capital marketplace.

(d) Current Canadian standards are considered by some to lack sufficient implementation guidance. Canadian efforts might be better focused on developing helpful guidance for applying FASB or IASB standards to Canadian circumstances (without changing the standards).

20 If the Board's current strategies need to be revised, what strategies might be developed for dealing with public companies? To begin with, the current strategies assume the continuation of a separate Canadian GAAP. The 2004 Invitation to Comment challenged that assumption, and the responses indicated that views have changed:[9]

(a) For Canadian public companies in international capital markets, there is generally thought to be no compelling need for a separate Canadian GAAP, even though some financial statement preparers, auditors and users prefer the less burdensome and rule-oriented aspects of Canadian GAAP relative to US GAAP. For those companies, both US GAAP and IFRSs are considered to be appropriate bases for providing useful information to their investors and creditors.

(b) For public companies in domestic capital markets only, there is no perceived need to abandon Canadian GAAP, at least in the near term. Financial statement preparers, auditors and users in this market strongly dislike US GAAP and appear to be more comfortable with something like current Canadian GAAP. Recognizing the importance of global convergence in the longer term, a number of companies prefer IFRSs over US GAAP and accept the possibility of Canadian GAAP evolving toward IFRSs.

21 The following discussions consider in more detail the two principal alternatives to current Canadian GAAP for public companies.

---

9 Some have questioned whether the Board would be abdicating its responsibilities if it were to abandon a separate Canadian GAAP. The Board's current terms of reference focus on serving the public interest by improving the quality of financial reporting by Canadian entities and pursuing the objective of global convergence. The terms of reference do not require the Board to maintain a separate Canadian GAAP. Most commentators did not appear to be concerned that the Board might cease to make the final decisions on the content of standards.

The role of US GAAP in Canada

22 When the Board's current strategies were being developed by the TFOSS, some Canadians favoured adopting US GAAP for at least some public companies. However, there was insufficient support for such a strategy at the time and less information than is now available to permit a full consideration of its implications. Market pressures subsequently persuaded some Canadian multinational public companies to move as close as they practically could to US GAAP reporting. Some adopted as many US GAAP requirements as possible as accounting policy choices within Canadian GAAP, and some developed secondary financial reporting under US GAAP. Some companies, relatively few in number but generally large in size, have been permitted to adopt US GAAP as the basis of reporting under securities laws.[10] As a result, Canadian public companies, their auditors and the users of their financial statements have become more familiar with US GAAP.

23 Some have proposed that US GAAP is superior to Canadian GAAP and should supplant it. Their arguments include the following:

(a) US GAAP is stricter than Canadian GAAP. US GAAP produces financial information that is more consistent over time for any given company and more comparable between companies. It provides for less choice of alternative treatments, and prohibits certain accounting treatments currently found under Canadian GAAP that some consider inappropriate.

(b) US GAAP is widely accepted internationally as the "gold standard" of financial reporting. No other set of standards is as widely accepted or as well regarded. Canadian GAAP is highly regarded compared to other financial reporting systems, but it is not as good as US GAAP and is not as widely known or well accepted outside Canada. Financial statement users in foreign markets want information that is comparable between companies from various countries.

---

[10] However, most of these companies have been unable to take full advantage of this feature of securities laws because changes are required to other laws that still require Canadian GAAP reporting. Recently approved amendments to the Regulations under the Canada Business Corporations Act effectively conform that legislation with the securities laws.

(c) US GAAP is generally more specific than Canadian GAAP because it is more extensive and covers more issues and more circumstances. It therefore provides more guidance for financial statement preparers and more certainty that a particular accounting treatment is "right", that is, in accordance with GAAP and, accordingly, accepted by everyone including regulators. As a result, there are fewer debates about what to do in a particular situation and less chance of a regulatory intervention or a lawsuit, which saves financial statement preparers and auditors both time and money.

24 Further arguments have been advanced in favour of Canada adopting US GAAP that are not based on the merits of the US standards.

(a) Some believe that the increased integration of the Canadian and US economies at most levels makes it inevitable that Canada must adopt US GAAP, regardless of its advantages and disadvantages. Not all of those who hold this view necessarily prefer that outcome.

(b) Some point to the considerable effort already made to develop US GAAP resources and expertise in Canada. They question why that investment should be wasted by abandoning it, and also suggest that it might be a competitive advantage for Canada.

(c) Reconciliation to US GAAP, even by way of an audited footnote, differs qualitatively from using US GAAP as the basis of preparing the financial statements. Reconciliation is widely accepted to be inferior by financial statement preparers and users.

25 Some of the support for US GAAP has waned since the 1990s. This appears to be due to the following factors:

(a) Some of the initial support for US GAAP was based on a single issue — the US pooling of interests method of accounting for business combinations. During market conditions prevailing in the mid-1990s, this feature of US GAAP was highly attractive to the many companies then active in mergers and acquisitions. The limitations on its use under Canadian GAAP were considered an inappropriate GAAP difference. This issue was subsequently resolved through the elimination of pooling of interests accounting from both Canadian GAAP and US GAAP as the result of a joint project of the Board and the FASB.

(b) As more Canadians became more familiar with US GAAP in detail, some of its shortcomings became more evident. In some circumstances, the more extensive guidance and more specific requirements were found to be arbitrary and precluded what otherwise appeared to be the best accounting. Debates on accounting issues were not necessarily reduced by applying US GAAP, but became focused on identifying what the relevant requirements were (see (c) below) or how to circumvent requirements that produced unsatisfactory results, rather than on what the best accounting would be.

(c) US GAAP is difficult to work with because it encompasses a very large body of accounting literature found in a variety of sources. Some of these sources can be hard to identify and obtain. On some issues, the various sources are not fully consistent.

(d) While US GAAP may be more rigorous in the sense of having more rules, it does not necessarily produce the most useful financial information. Tests of the quality and relevance of US GAAP information against information prepared under other sets of standards have indicated that Canadian GAAP (and some other sets of standards) may provide information that is more useful to investors.[11]

(e) The financial scandals at Enron and other US public companies demonstrated significant shortcomings of the US financial reporting system. It is now widely accepted that rules do not necessarily result in better financial reporting. The reputation of the "gold standard" was tarnished as many around the world questioned whether US GAAP was too "rule-based" and not sufficiently "principles-based".

---

[11] See, for example, the paper by Daniel B. Thornton and Erin Webster, "Earnings Quality under Rules- vs. Principles-Based Accounting Standards: A Test of the Skinner Hypothesis" (June 2004), at http://ssrn.com/abstract=557983. The papers cited in footnote 6 also indicate that financial statement users do not obtain useful financial information from the reconciliations of reported Canadian GAAP amounts to corresponding US GAAP amounts.

(f) As discussed further below, the financial scandals occurred at almost the same time that the new IASB began operations, with the prospect of providing Canada (and other countries) with a realistic alternative to US GAAP as a basis for achieving convergence on a single set of high-quality, internationally accepted standards.

(g) The response to the financial scandals has included changes to the US system that increase the dominance of the SEC and the potential for regulatory interference in standard setting. US GAAP is not just the standards of the FASB; it is whatever the SEC requires, including a number of rules it sets directly. In addition, members of the US Congress have tried to interfere in financial reporting issues from time to time, through the SEC or directly through legislation. Most recently, some members of Congress tried to block the FASB's project on stock-based compensation of employees. These interventions are not necessarily in the general public interest. There is a general view that the US system is unlikely to be responsive to the issues and concerns of Canadian companies and Canadian investors, and that the IASB offers a more receptive forum for Canadian input and influence.

26 Despite the factors summarized in paragraph 25, US GAAP remains a high-quality basis of accounting that is widely accepted in capital markets globally. The US standard setters and regulators are taking steps to address perceived deficiencies in the US system. In one form or another, US GAAP continues to be a prerequisite to entry into US capital markets, the predominant foreign source of capital for Canadian businesses and the predominant foreign market for Canadian goods and services. Canadian SEC registrants, an important subset of the Canadian public company sector,[12] must either use US GAAP as their primary basis of reporting to investors or reconcile Canadian GAAP financial statement amounts to US GAAP equivalents. Even though Canadian GAAP has been harmonized to a significant extent with US GAAP on key issues, there is no prospect in sight of the SEC permitting Canadian GAAP to be used in US markets without the

[12] More than half of the TSX-listed companies by market capitalization (approximately 200 by number) are SEC registrants.

reconciliation.[13] Canadian SEC registrants are therefore locked into the use of US GAAP.

27 The role of US GAAP and its suitability as the basis of financial reporting for certain Canadian public companies have been recognized by the Canadian Securities Administrators through their National Instrument 52-107, *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (NI 52-107). NI 52-107 permits Canadian SEC registrants to use US GAAP in place of Canadian GAAP in satisfying the requirements of provincial securities laws for reporting to investors (subject to certain conditions). Changes to some business corporation laws have been made or are being proposed to achieve the same result, but a variety of other federal and provincial laws containing financial statement requirements have not been similarly changed.

28 The ability to choose US GAAP under NI 52-107 has been limited to Canadian SEC registrants. The stated purpose of the limitation was to reduce the cost burden on Canadian SEC registrants of having to deal with two sets of GAAP. The limitation has certain practical merits. The supply of US GAAP expertise in Canada is mostly limited to the accountants working in the few hundred Canadian SEC registrants and their auditors. Working with US GAAP requires a considerable investment in reference materials, training, accounting systems and the time needed to apply the requirements in practice. The Canadian accounting "system" (encompassing, among other components, education, auditing standards and practices, corporate and professional governance and regulatory oversight) has been developed to work primarily with Canadian GAAP and may not work as well with US GAAP.[14] These are all issues considered by the securities regulators in formulating NI 52-107. However, although NI 52-107 might work for the relatively small number of Canadian SEC registrants, there are already indications that resources are inadequate to deal with the implications of importing individual US GAAP

---

[13] The SEC's Multi-Jurisdictional Disclosure System (MJDS) permits qualifying Canadian companies some relaxation of the GAAP reconciliation requirement. However, in 1998, the SEC proposed changes to its regulatory approach that could affect the MJDS.

[14] For example, in the US environment, US GAAP is applied with a relatively heavy dose of compliance oversight and enforcement actions.

standards for wider application in Canada under the Board's current harmonization strategy, and the situation could worsen.

29 Practical considerations aside, however, are there any compelling arguments in principle for preventing a Canadian public company that is not a SEC registrant from applying US GAAP? If US GAAP is an acceptable basis of reporting for public companies and comparability between public companies is an important consideration, then there are grounds for giving all public companies the choice. Also, since the use of US GAAP would be a matter of choice by individual companies, only those non-SEC registrants that believe it more useful to them and their investors and creditors would choose it. Presumably, companies would do so only after considering their ability to apply US GAAP and the associated costs. The Board believes that a decision about the acceptability of US GAAP as an alternative basis of financial reporting entails a consideration of public policy issues that are best decided by the competent authorities (government and regulators). The Board will raise the issues with those authorities and provide any assistance they may request in making such changes to their current requirements as they deem appropriate. The Board believes its strategy can accommodate whatever decisions the authorities may make in this regard.

Adopting IFRSs in Canada

30 When the Board's current strategies were being developed in the mid-1990s, people wanted more emphasis placed on the US harmonization strategy and many thought US GAAP to be the only reasonable alternative to Canadian GAAP and the most likely path to international convergence. Recent changes in circumstances have indicated that IFRSs are becoming a credible alternative to US GAAP as a set of internationally recognized, high-quality accounting standards.[15] Canadians are generally not as knowledgeable in detail about IFRSs as they are about US GAAP but they recognize the substantial movements in Europe, Australia, New Zealand and other countries to adopt IFRSs as a strong indicator of their credibility. Furthermore, the Board has been intimately involved

---

[15] Refer to the discussion about the evolution of IFRSs in the 2004 Discussion Paper.

in the development of international accounting standards throughout the history of the IASB and its predecessor body.

31 IFRSs have developed into a body of accounting literature approximately equivalent to Canadian GAAP in volume and coverage. They are similar to Canadian standards in approach and style, even though they take different positions in a relatively few instances on points of principle. In particular, they are relatively principles-oriented and relatively unencumbered by arbitrary exemptions, special treatments and other rules. IFRSs have evolved to the point where they offer few free choices of accounting principles. They also contain reasonably rigorous guidance for applying principles.

32 The question asked by some commentators is whether IFRSs have been tested in practice and proven reliable in producing useful information. Although the IASB has been operating for about four years, some also wonder whether its structure and processes have been tested sufficiently. The answer must be that, while the structure and processes appear to be sound and have produced a considerable volume of both new and improved standards since the IASB's inception, the output has not been tested yet on a wide-scale basis. The application of IFRSs to listed (public) European Union companies and all Australian reporting entities beginning in 2005 is the real test, and the outcome may not be clear until 2007 or 2008.

33 A significant indicator of the success of IFRSs will be the position taken by the SEC on the financial reporting by the hundreds of European and Australian public companies that have entered into US capital markets. All of these companies will remain subject initially to the same requirement as Canadian SEC registrants that they prepare a reconciliation of their IFRS financial statements to US GAAP equivalents. The SEC has announced its intention to review rigorously the quality of IFRS financial statements issued in 2005-2006 in Europe and elsewhere. The SEC has indicated that it expects to reconsider the need for that reconciliation for IFRS financial statements after reviewing their quality (but has not indicated a similar expectation in respect of Canadian GAAP or any other sets of standards). The SEC staff has suggested that this reconsideration could take place somewhere in the 2008-2010 timeframe.

34 The Board, the IASB and the FASB, together with other national standard setters, are already engaged in a process designed to achieve global convergence by working together on all significant standard-setting projects. The boards have agreed to align their agendas, work co-operatively by sharing resources and deliberating issues in parallel, and seek to achieve common answers on all significant issues. The working relationships begun on the inception of the IASB have strengthened over time. In particular, the FASB has agreed to a very close working relationship with the IASB. The benefits of this process are now becoming apparent as work proceeds jointly on topics such as revenue recognition, business combinations, financial performance reporting, various financial instruments issues and improvements to the conceptual framework. In addition, the IASB and the FASB have eliminated certain of the differences between their standards through a short-term convergence project. The Board intends to amend its standards where necessary to eliminate differences from the converged standards resulting from the IASB/FASB project.

35 As long as the convergence process continues successfully along current lines, the differences between various sets of standards will gradually disappear as various topics are dealt with and common standards arrived at. The same result will be achieved on these topics whether Canada retains its own GAAP for its public companies, adopts US GAAP or adopts IFRSs. The ongoing differences will flow from the "legacy" issues not addressed since the inception of the standard-setting partnership arrangements and carried forward from earlier times.

36 It is likely that significant differences between US GAAP and other sets of standards will persist for some time while the FASB deals with its large body of legacy issues.[16] There are far fewer legacy issues between Canadian GAAP and IFRSs than currently exist between Canadian GAAP and US GAAP. IFRSs have been substantially overhauled since 2001 as a prelude to their adoption by the European Union, based in part on a comprehensive evaluation by the International Organization of Securities Commissions

[16] As noted above, US GAAP contains a vast amount of material that the FASB is attempting to codify in one source, a project expected to take up to five years to complete.

in the late 1990s. In addition, the Board has taken steps in recent years to minimize differences between IFRSs and Canadian GAAP even while harmonizing with US GAAP. A significant factor for Canada in deciding between US GAAP and IFRSs is the considerable body of legacy issues that would need to be dealt with over time if US GAAP were selected. That would be a more difficult and indirect path to the ultimate goal of global convergence than direct adoption of IFRSs.

37 Although Canada has had considerable input and influence in the development of international accounting standards, its influence is likely to diminish unless it declares an intention to align Canadian GAAP with IFRSs. Countries that have adopted IFRSs have lobbied to increase their say in the development of new standards at the expense of other countries. While the United States has an unassailable role in international standard setting, Canada does not and is sometimes viewed as an adjunct of the United States. Canada is one of very few developed economies other than the United States that has not yet adopted a formal plan to converge with IFRSs.[17]

38 The Board plans to continue working with both the IASB and the FASB to encourage them to maintain their current close working arrangements and their objective of global convergence. The Board intends to continue to play an influential role in international standard setting, which will be dependent largely on the quality of the thinking it contributes and the effort it puts into the process.[18]

39 While the majority of respondents to the 2004 Invitation to Comment who favoured moving away from a separate Canadian GAAP preferred IFRSs over US GAAP, it is evident that Canadians are generally much less familiar with IFRSs than with US GAAP. The Board recognizes that Canadians need additional information about IFRSs to be in a position to provide informed comment on the proposed strategy for public companies. A staff-prepared summary issued concurrently with this Invitation to Comment provides a

---

[17] In October 2004, Japan announced its intention to participate in a convergence project with the IASB, the latest such announcement from a major economy.

[18] The Board's participation in international standard setting is described in the 2004 Discussion Paper and on the Board's website (www.acsbcanada.org).

macro-level comparison of Canadian GAAP and IFRSs to indicate the extent of differences that might have a significant effect on current Canadian practice. A more extensive technical comparison will also be published for those who are interested in the greater level of detail.

Differential reporting for public companies

40 The 2004 Invitation to Comment raised the question of differential reporting for smaller public companies. Under such an approach, certain public companies would be provided with the option of adopting alternative, less burdensome accounting treatments and reduced disclosure requirements. Respondents to that Invitation to Comment were clearly opposed to that idea, taking the view that all public companies should be held to a similar standard of accountability. The Board is not aware of any major capital market that allows differential reporting among public companies.

The way forward

41 Pulling together all of the various points outlined above, the Board has concluded that it is no longer in the interests of public companies, the users of their financial statements or other stakeholders to maintain a separate Canadian GAAP for public companies beyond a limited transition period. Under the current strategies, Canadian GAAP would increasingly converge with US GAAP and IFRSs in any event, but the process would be drawn out over an extended period. It is time to contemplate in specific terms the end of Canadian GAAP as a separate and distinct basis of financial reporting for public companies, and plan for an orderly transition.

42 The Board recognizes the practical need for some public companies to adopt US GAAP, and accepts that US GAAP is appropriate as an alternative basis of reporting for public companies.

43 The Board proposes the following approach to achieve a changeover to IFRSs:

(a) The Board will continue with its current policy of working with the IASB and other standard setters in the international standard-setting partnership, in accordance with its undertakings to those bodies. It will participate in developing new, high-quality standards on topics on the common global standard-setting agenda, and then adopt them as Canadian standards.

(b) The Board will wind down activity on its few remaining “Canadian only” projects and on US GAAP harmonization projects that are not also on the global agenda. The Board will continue to develop guidance necessary for proper application of IFRS-based standards in the Canadian environment.

(c) The Board will focus its efforts on a program of modifying current Canadian GAAP to eliminate significant differences from IFRSs on those topics not on the global agenda. Current Canadian standards for which there are no corresponding IFRSs will be retained with any amendments necessary for consistency.

(d) On the changeover date (discussed further below), the Board will replace Canadian standards with the corresponding IFRSs, eliminating any residual differences. Those differences are expected to be relatively minor by the changeover date.

The details of the work program necessary to carry out this approach will be determined following adoption of the strategic plan, and then published for the information of all affected parties. Such details will include the order in which individual topics will be addressed and the expected timing of the Board’s work.

44 The Board considered carefully the timeframe in which it is reasonable to carry out the transition described in paragraph 43. The Board believes that the transition process should begin as soon as a decision to adopt the new strategy has been made, and should not be extended unduly. On the other hand, the modifications to current Canadian GAAP to converge with IFRSs will take some time to put in place in accordance with normal due process, and some time for companies to implement. The Board believes that five years is a reasonable period over which to make the transition, but will reconsider when the final changeover to IFRSs should occur as the transition progresses.

45 A related implementation issue is whether the IFRS convergence changes referred to in paragraph 43(c) should become effective all at once on the changeover date (a single-step approach) or be phased in over the transitional period as they are introduced into the Handbook. Views on this point may differ. From past experience, the Board observes

that some companies prefer to avoid making accounting changes every year, because it is hard for the users of their financial statements to accommodate a series of changes, and it is also burdensome on preparers and auditors. These companies may prefer to establish a plan to prepare themselves and financial statement users for a single-step changeover with ample advance notice and preparation time. Other companies may prefer to introduce changes at various times during the transitional period to allow users and preparers to cope with them a few at a time. From a financial statement user's perspective, having different enterprises applying different standards in the same reporting period makes comparisons more difficult. In addition, the special transitional provisions in IFRS 1, *First-time Adoption of International Financial Reporting Standards*, may not be available under the phase-in approach in some circumstances.

46 The Board could impose one of the two transitional approaches, but could also consider providing companies with a free choice of approach to accommodate the wide range of circumstances that may arise in practice. The free choice could be provided for individual standards or for groups of standards collectively. Under a free choice approach, some changes to be made to current Canadian GAAP to achieve conformity with IFRSs would become effective for fiscal years beginning on and after the changeover date, but may be applied earlier. ***The Board invites comment specifically on the question of which transitional approach to adopt.***

47 Readers will be able to determine in a general way what the accounting changes from the IFRS convergence strategy will be from information provided in a separate staff-prepared analysis of Canadian GAAP/IFRS differences. However, the Board will assess the amendments to be made and the timing of their introduction in detail only after adopting the proposed strategy. The work program arising from this assessment will be developed as soon as possible after adoption of the strategy.

48 The Board considered the possibility that the initial application of IFRSs in European Union countries and Australia in 2005 might reveal some difficulties with those standards or some lack of acceptance by financial statement users. The experiences in those countries will also provide useful insights about how to effect a transition. Accordingly,

the Board's transition program will include a major checkpoint at approximately 24 to 30 months from its inception. At that point, the Board will review its own progress in carrying out the plan and also circumstances in the financial reporting environment generally, both in Canada and internationally. The AcSOC will monitor this review, and the Board will consult with the AcSOC. The SEC's proposed reconsideration of the US GAAP reconciliation requirement would provide a useful gauge of the overall acceptability of IFRSs, and would be an important factor for the Board in making a final decision about the proposed changeover to IFRSs. Following the review, the Board will decide whether to proceed to complete the plan as initially formulated, or vary it in some fashion in light of experience (for example, by altering the changeover date).

49 Although the Board will expose proposals to adopt or amend individual standards under the transition program, it will not necessarily seek public input for its checkpoint review or expose for public comment any resulting modification to the plan. ***Readers should respond to this Invitation to Comment if they wish to comment on the Board's proposed strategy for public companies, rather than waiting for the checkpoint review.***

50 Following the changeover date, the Board will continue importing new and amended IFRSs individually as they are issued and incorporating them into the Handbook, in accordance with due process. This process will be necessary as a mechanism for making IFRSs applicable in Canada, at least until such time as laws and regulations applicable to financial reporting have all been changed to make direct reference to IFRSs. Although the Board's terms of reference give it the authority to set standards in Canada, implied in the proposed strategy is a commitment that it cease to make final decisions on the technical content of individual standards, as well as the timing of their implementation, in all but the most exceptional circumstances. The Board accepts this as the inescapable consequential effect of assuming the role of a national standard setter in a global market context. However, the Board will continue to participate vigorously in the development

of IFRSs, and also take steps to increase the involvement of the users, preparers and auditors of Canadian public companies' financial statements in that process.[19]

51 The Board will co-operate with legislators, regulators and others in changing their current financial reporting requirements, if and when those authorities decide to make changes consistent with the direction of the Board's strategy.

Private businesses

52 The Board's strategy for private businesses is as follows:

(a) The Board will undertake a comprehensive examination of the needs of the users of these businesses' financial statements and then determine the most appropriate financial reporting model to meet those needs. This will require research to identify more clearly who the financial statement users are, what their information needs are and what reporting model or models might best satisfy those needs. The Board has no preconceived idea of the outcome of this process, but notes that the possibilities include both a set of standards not very different from current standards and a set of standards that is substantially different from current standards.

(b) The proposed research may be conditional on obtaining additional resources and will take some time to complete, during which the current differential reporting model will remain in place. Currently existing differential reporting alternatives will be maintained, and any additional alternatives will be developed through the current process with the advice of the Board's Differential Reporting Advisory Committee.

(c) The Board will clarify that GAAP requirements are intended to apply only to entities that have significant external users of financial information and require

---

[19] The Board notes that, although there is currently a Canadian member of the IASB, Canada is not guaranteed a seat on the IASB. Active Canadian involvement in the development of IFRSs may increase the chances of continuing to have a Canadian appointed to the IASB, as well as having Canadian circumstances addressed and Canadian views heard.

the application of a common basis of financial reporting. The Board will take steps to limit the scope of its standards to such entities, thereby exempting a number of smaller private businesses that do not need GAAP financial statements.

53 Just as the preceding section of this draft plan used the term “public company” in a general and somewhat loose sense, this section uses the terms “private business” and “small company” in the same manner. The Board notes that some private businesses are quite large and complex, and not all small companies (however one construes “small”) are private. This section of the draft plan deals essentially with all profit-oriented entities that are not publicly accountable, substantially in the sense defined in DIFFERENTIAL REPORTING, Section 1300 of the Handbook.

54 The 2004 Invitation to Comment raised questions about differential reporting. Differential reporting was meant partly in the broad sense of any approach providing different financial reporting standards for different types of entities. It was also meant in the more specific sense of the current model of differential reporting for non-publicly accountable enterprises under Section 1300. In response, the Board received a substantial amount of commentary, mostly concerning financial reporting by small businesses and much of it delivered with considerable intensity. While some commentators felt that the current differential reporting model in Section 1300 is working satisfactorily or, at least, has the potential to do so if alternative treatments were provided on some additional issues, the majority of commentators felt that the model is not working and needs replacing.

55 The Board noted several aspects of the comments that have a bearing on the proposed strategy for private businesses, as follows:

(a) Most of the comments came from public practitioners providing accounting services to small businesses, rather than from the users of the financial statements of those businesses or the owner-managers. The comments focused on concerns about “standards overload”, which encompasses a wider array of factors than accounting standards. Accounting practitioners have faced a substantial increase in the various requirements they must apply, including independence standards, auditing standards and a variety of requirements applicable to serving their public company clients (if any). Their comments also focused on the cost/benefit tradeoff in applying GAAP accounting requirements to private businesses. They can see little benefit to the users of financial statements from a number of disclosures and accounting treatments required by GAAP, while they and their clients bear the costs.

(b) The Board received some input from bank lenders, who are often the principal external users of the financial statements of private businesses and sometimes the only such user. This input was not consistent with the input from the accounting practitioners in some important respects. Bank lenders want reliable financial statements, by which they generally mean audited financial statements prepared in accordance with a predetermined, reliable basis of accounting. They sometimes accept less reliable financial statements (either unaudited or non-GAAP, or both), but there may be a trade-off between the quality of the information they receive and the cost of the credit they extend, depending on the security and other terms of a loan.

(c) The Board was advised that there are significant differences between the Canadian and US environment that affect financial reporting by private businesses. The United States has no general statutory requirement for private companies to apply GAAP. Many non-public US companies do not prepare GAAP financial statements. In general, US lenders put less reliance on their customers' financial statements because they do more asset-based lending and, accordingly, are more willing to accept non-GAAP financial statements (or even none at all).

(d) There was little support for the idea suggested by a few commentators of letting the marketplace decide which accounting methods are acceptable or letting individual companies and providers of capital negotiate accounting methods privately. This approach was considered impractical because it is inefficient and may leave financial statement users at a disadvantage.

(e) Some commentators recommended fundamental changes in the approach to setting accounting standards for private businesses, and some recommended that the Board undertake more research as a basis for identifying some new approaches.

56 The current Section 1300 model of differential reporting assumes that:

(a) the owners of a private business and its principal creditors (usually banks) are often the only users of its financial statements;

(b) owner/managers do not need standards for preparing financial statements because they can develop whatever financial information they want;

(c) lenders are in a position to require GAAP-basis financial statements as a condition of any lending agreement if they want that quality of financial information, although not all lenders may need it and some may specify other information they want provided;

(d) similarly, others to whom a business has substantial obligations, including tax authorities or other government agencies, have the ability to require the business to provide the financial information they need for their purposes;

(e) the only financial statement users who may need GAAP-basis financial statements are owners who are not involved in the management of the business, as they have no power to obtain financial information other than through their statutory rights to financial statements and no practical way of specifying what information they want;

(f) a “mix-and-match” menu of accounting alternatives chosen by individual entities is more responsive to their needs than a single alternative set of standards; and

(g) enterprises that qualify for differential reporting should be permitted to use the same accounting treatments that the standard setter requires for enterprises that do not qualify for differential reporting.

57 Some of these assumptions were challenged in the responses to the 2004 Invitation to Comment. For example:

(a) Some lenders feel that they cannot always insist on receiving GAAP-basis financial statements as a condition of lending, although the Board notes that this is a commercial decision and likely one of many factors in the negotiation of a lending agreement.

(b) When all of the owners of a business agree that they do not need financial statements prepared in accordance with current GAAP, even those prepared on a differential reporting basis, and no other party requires them, there is currently no mechanism in law or in accounting standards that permits them to adopt another basis of accounting.

(c) The "mix-and-match" menu of accounting alternatives impairs comparability and may confuse financial statement users. Users need to identify for each entity which alternatives have been used and how the set of alternatives adopted affects comparability with other entities. As the number of alternatives increases, the number of possible accounting policy combinations increases exponentially. The Board notes that the "mix-and-match" approach has been adopted by some standard setters but rejected by others.

GAAP is not for all entities

58 The Board believes that one of the key issues is whether GAAP should be modified to accommodate better the various quite divergent financial reporting needs of all businesses, or be confined to meeting the needs of those businesses that have substantial external stakeholders. FINANCIAL STATEMENT CONCEPTS, paragraph 1000.01 of the Handbook states (emphasis added):

> The purpose of this Section is to describe the concepts underlying the development and use of accounting principles in <u>general purpose financial statements</u> … Such financial statements are designed to meet the <u>common information needs of external users</u> of financial information about an entity.[20]

From this statement and others in paragraphs 1000.01-.15, the Board infers that a set of accounting standards such as GAAP is not necessary for all entities, only for those entities that have significant external users of financial information and require the application of a common basis of financial reporting. By definition, a standardized basis

[20] The conceptual frameworks of the IASB and the FASB state essentially the same focus for the standards that those bodies issue.

of reporting cannot be tailored to suit the specific needs of individual entities or particular classes of users.

59 The Board is well aware that many private businesses routinely have their public accountants prepare non-GAAP financial statements that suit the needs of the businesses' owners. However, public practitioners point out that current audit and review standards push them into "downgrading" to compilation engagements with their clients to avoid having to qualify their report on these non-GAAP financial statements.[21] Public practitioners undertake this "downgrading" reluctantly, and some have commented that the minimal level of assurance they provide does not serve the users of their clients' financial statements well.

60 The Board's mandate is to improve financial reporting in Canada and, in furtherance of that mandate, to specify what Canadian GAAP is. The Board believes that it has the power to limit the scope of its own standards, and proposes to include in the Introduction to the Handbook a statement to the effect that those standards do not apply to financial statements other than general purpose financial statements prepared for external reporting purposes, as described in Section 1000. Private businesses that do not prepare such financial statements will have the option to apply GAAP as a matter of choice, but only with the accounting treatments that apply to other categories of profit-oriented enterprises.

61 The question of which entities do not need GAAP-basis reporting will require some further consideration and a clear statement of the scope of GAAP standards. However, consistent with the discussion above, such entities will generally be those without significant external stakeholders and may also include those businesses with external stakeholders who have indicated specifically that they do not need GAAP financial

[21] Current audit and assurance standards require public accountants to qualify their reports on non-GAAP financial statements by stating that they are not in accordance with GAAP and, in the case of an audit, also quantifying the amount of the differences from GAAP when it is practicable to do so. Some public accountants consider that the qualification creates a negative connotation in the minds of the users of the financial statements or confuses them. Quantifying the effects of GAAP departures requires that all of the work necessary to apply GAAP must be done by the auditor.

statements. The Board's definition of external stakeholders includes shareholders who are not also managers of a business, and creditors. It excludes government agencies and regulators that have the power to require individual entities to provide them with financial statements on a specified basis (as distinguished from those agencies and regulators that have the power to require entities to provide external users with financial statements).

62 The Board will communicate with the competent government authorities, the Auditing and Assurance Standards Board and the professional accounting bodies in order that they may review and revise as appropriate the current audit and assurance requirements in law, standards and rules of professional conduct in light of the Board's new strategy. The Board proposes that any relief from the current requirements be provided to entities on a basis consistent with the relief provided from requirements for GAAP financial statements.

63 This course of action will require the Board to take certain steps, as follows:

(a) The Board will need to review the scope of its powers and responsibilities, in the first instance with the AcSOC but possibly also taking legal advice.

(b) The Board will need to consult with government and regulatory bodies before proceeding, to ensure that they are aware of the Board's approach and the Board can take their views into account.

(c) Similarly, the Board will need to consult with the Auditing and Assurance Standards Board and professional bodies to permit them to re-evaluate and, if appropriate, adjust their requirements for consistency with the Board's approach.

(d) The Board will need to provide some lead time to permit affected parties to adjust to the proposed limitation in the scope of GAAP standards before it comes into effect.

(e) The Board will assist others in providing any guidance for entities exempted from GAAP standards.

64 Other countries that do not apply GAAP to a significant number of smaller entities have generally developed little or nothing in the way of standards or guidance for them. Any attempt to develop a limited body of requirements outside GAAP but based on the same conceptual foundations could possibly end up not very different from GAAP. Any such non-authoritative guidance is presumably designed to help individual financial statement preparers determine what accounting policies and practices might be best suited to their particular circumstances. The Board believes that it is not the body best placed to develop and issue such non-authoritative guidance, partly because it lacks the resources and expertise to take on the task. However, the Board will co-operate in establishing a mechanism for developing such guidance.

65 A full implementation of the approach described above may require other bodies to take steps and, accordingly, is not fully in the Board's control. Full implementation could easily take several years. Nonetheless, the Board intends to begin taking the steps within its control as soon as the strategy has been finalized and adopted. It expects those steps could be completed in approximately one year from their initiation, but the approach would not become effective for at least another year and likely longer, pending action by others.

Differential reporting on a GAAP basis

66 The preceding section of this Invitation to Comment deals with only one part of the private business sector. A number of private businesses will be required to continue to apply GAAP under the approach proposed in that section because they have significant external stakeholders who require general purpose financial statements (or are deemed by law to require them). What can the Board do to address the concerns expressed about current Canadian GAAP as it affects these businesses?

67 Considerable work went into developing the current differential reporting model in Section 1300 of the Handbook, which was designed to address the concerns of private businesses. That model goes the farthest toward providing differential treatments for private businesses within GAAP (or its equivalent) of any other such model in the

world.[22] Going much further, as some suggest, means proceeding into uncharted territory.

68 The Board acknowledges that the current differential reporting model in Section 1300 needs reconsideration. At the same time, none of the recommendations made by respondents to the 2004 Invitation to Comment for a different approach (including the "core GAAP plus enhanced GAAP" model) appear to be workable.[23] Some respondents to that Invitation to Comment urged the Board to undertake research to achieve a better understanding of who the users of private businesses' financial statements are, what information they need and what information satisfies the cost/benefit constraint in the conceptual framework.

69 The Board believes it needs to obtain more information before embarking on a new approach to differential reporting, although it recognizes that a strategy based on carrying out further research and study could become a basis for inaction. The research must be focused on obtaining concrete information to support a conclusive evaluation of user needs and the cost/benefit trade-off; it cannot be just a survey of opinions or current practices. The Board is committed to making decisions based on the research within a reasonable period of time, but can make no commitment about the outcome of the process.

70 Part of the research that the Board expects to undertake is to review the results of all of the work done to date on the topic of differential reporting for private businesses within GAAP, both within Canada and internationally. The Board plans to consider, among other things:

(a) the information gathered by the CICA Study Group that produced the 1999 Research Report, *Financial Reporting by Small Business Enterprises*;

---

[22] Only a few countries have adopted a differential reporting regime within GAAP (notably the United Kingdom and New Zealand). The IASB is contemplating developing such a regime for non-publicly accountable enterprises. The United States achieves a form of differential reporting outside GAAP through "other comprehensive bases of accounting".

[23] See the discussion in paragraph 11.

(b) studies done of the application of Section 1300 in practice;

(c) the responses to the 2004 Invitation to Comment that provide some specific information about issues of concern to the private business sector;

(d) information made available by the American Institute of Certified Public Accountants on its Private Company Financial Reporting project;

(e) the work of the FASB's Small Business Advisory Committee;

(f) developments in the IASB's project on Accounting Standards for Non-Publicly Accountable Entities (NPAEs); and

(g) developments in the evolution of the UK and New Zealand differential reporting models, which are occurring in the context of the adoption of IFRSs in both of those countries.

The Board will also continue to consult its Differential Reporting Advisory Committee, which is charged with assisting the Board in the application of the current Section 1300 model.

71 As a result of the Board's strategy for public companies, Canadian GAAP will be modified in the medium term. When the changeover to IFRSs occurs, private businesses might have the option of adopting the IASB's standards for NPAEs, if those standards have been finalized at that point. However, the IASB's project on NPAEs may not result in a set of standards that Canadian private businesses will find responsive to their needs, based on the preliminary views in the IASB's June 2004 Discussion Paper[24] and comments received by the Board in response to its 2004 Invitation to Comment. To the extent that the Canadian private business sector participates in the further development of the IASB's standards for NPAEs, companies in that sector might be willing to accept those standards. However, the Board does not believe that it can afford to wait until further progress has been made on the IASB's project before undertaking its own research.

---

[24] The IASB has begun considering the responses to its Discussion Paper and has tentatively agreed to pursue approaches different from some of those originally proposed. Among other matters, the IASB has decided that its project should deal with NPAEs, rather than small and medium-sized enterprises (SMEs).

72 In proceeding with a separate, made-in-Canada approach based on its research findings, the Board will be creating a new set of standards for private businesses from basic principles. The Board expects that any new standards will be based on the current conceptual framework, but focused on the specific needs of the users of private companies' financial statements and the cost/benefit trade-off for those companies.

73 This new set of standards for private businesses will not be "differential" in anything like the sense of Section 1300 or the proposed "core GAAP plus enhanced GAAP" model, because it will not be tied to any other set of standards. As a result, these standards can be more readily tailored to suit the needs of the Canadian private business sector, unencumbered by any historical accumulation of requirements designed with other needs in mind. The new standards can also be formulated and described (labelled) in a manner that does not make them appear to be "second class GAAP", thereby addressing one of the concerns with the current differential reporting model. Although developed "from the ground up", the new standards may borrow some components from IFRSs or from current Canadian GAAP, including the existing differential reporting alternatives. The net effect of this process cannot be predicted and the Board has no preconceived idea of the outcome, but it is possible that the conceptual framework and the research findings could lead the Board to create a set of standards that is not very different from current Canadian GAAP.

74 To implement this strategy, the Board will need to carry out the research program and also several of the steps summarized in paragraph 63.[25] Those steps that are generally within the Board's control are expected to take between two and three years, although there is some uncertainty in this estimate. The research program will likely take the most time to complete. Other steps outside the Board's control could take longer. Once all of the necessary steps have been completed and the new set of standards has been issued,

---

[25] In particular, the Board would need to consult with government and regulatory authorities, the Auditing and Assurance Standards Board and professional organizations so that the requirements of these other bodies are co-ordinated with the new accounting standards. The Board would carry out the steps in paragraph 63 for both parts of its private business strategy together, and also in conjunction with similar steps required for its public company strategy.

additional time will be necessary to allow affected parties to prepare for the changeover. Accordingly, a new set of Canadian standards for private businesses will take several years to put into practice.

75 The Board will require additional staff resources, particularly people with knowledge of the private business sector, to undertake the research and consultation necessary to develop the new standards for private businesses and support their implementation in practice. The Board currently expects that it may need to increase its staff complement by 15-20 percent (an estimate that will require further refinement if the strategy is adopted), and will need some staff assistance from various professional accounting bodies. Additional volunteer resources will also be required.

The not-for-profit sector

76 The Board's strategy for the not-for-profit sector is as follows:

(a) Not-for-profit organizations (NFPOs) will continue to apply those elements of GAAP for profit-oriented enterprises that are applicable also to the circumstances of NFPOs. The Board will consult with the not-for-profit sector to determine whether all NFPOs should base their accounting on the standards for public companies, or whether some might base their accounting on the standards for Canadian private businesses or be exempted from the scope of accounting standards altogether.

(b) The Board will continue its current practice of developing standards that deal with the special circumstances of NFPOs, and will focus more of its attention on addressing those circumstances.

77 The Board recognizes that it has a responsibility to provide standards for this large and important sector, and that what applies to profit-oriented enterprises is not necessarily appropriate for NFPOs. The Board has recently instituted a structure and process for obtaining greater assurance that its standard-setting activities take appropriate account of the unique circumstances and needs of the not-for-profit sector. It has also initiated a

project to revisit the standards established specifically for NFPOs in the mid-1990s to determine whether those standards require improvement.[26]

78 The 2004 Invitation to Comment invited comment from all sectors and all stakeholders, but the Board received relatively little input from, or specifically about, the not-for-profit sector. The Advisory Committee has provided its input, which includes the following points:

(a) The concern for most NFPOs is that standards be relevant and of high quality, and not be onerous and costly to apply. The issues of current concern to NFPOs are standards overload and cost of compliance, and the complexity of reporting to financial statement users.

(b) International and US standards may represent a form of "best practices" for further developing NFPOs' accounting and reporting practices. However, IFRSs are not developed for application to NFPOs and US standards for NFPOs are structured in a way that makes it difficult to import some of them directly.

(c) The derivation of a particular standard (IFRS, US or domestic) is not very important to NFPOs.

(d) While some favour different reporting in different circumstances, there is also concern about the potential for negative perceptions of different levels of GAAP.

79 The Not-for-Profit Organizations Advisory Committee has supported the view taken by the Board to date that NFPOs are, in general, publicly accountable to a potentially large and diverse group of members, contributors and creditors, and should therefore be held to the same standard of accountability as public companies. Accordingly, when a NFPO is dealing with the same transactions, circumstances or financial statement elements as a public company, there is a presumption that it should apply the same accounting. Special accounting standards for NFPOs have generally been designed to address unique

[26] The Board has established a Not-for-Profit Organizations Advisory Committee to review and comment on all standards relative to NFPOs. Both the structure and process of the Advisory Committee and the Board's project to improve current standards are described in more detail on the Board's website (www.acsbcanada.org).

circumstances of these entities, not to create differential reporting alternatives as in the private business sector.

80 The fundamental changes to current Canadian standards proposed in the strategies for the profit-oriented sector will have significant effects on not-for-profit sector accounting, and need to be addressed separately in the context of NFPOs. If the Board adopts the "one size does not necessarily fit all" strategy in the profit-oriented sector, it would be natural to consider applying it also in the not-for-profit sector. This sector has a profile similar to that of the profit-oriented sector — a small number of relatively large, complex entities often accountable to a large and diverse group of stakeholders, and a much larger number of relatively small, simple entities, many of which are accountable to a small and homogeneous group of stakeholders. The issues are, then, how to apply the strategies for the profit-oriented sector to the not-for-profit sector and when to apply a separate strategy specifically for the not-for-profit sector.

81 The Board notes that, as in the profit-oriented sector, some entities in the not-for-profit sector appear not to need GAAP because they do not need to provide general purpose financial statements to external users. For example, a private club or association with only a small group of members could decide that they do not need GAAP financial statements. The Board proposes to apply the same approach to these entities as to certain private businesses by excluding them from the scope of accounting standards generally. Substantially the same steps and the same amount of time will be necessary to carry out this strategy for NFPOs as for private businesses (see paragraphs 62-64).

82 For those NFPOs that continue to prepare GAAP-basis financial statements, the convergence of Canadian GAAP for public companies with IFRSs will result in some changes to current accounting practices. These changes are not expected to differ significantly, in terms of NFPOs' ability to cope with them, from the changes made to Canadian GAAP in recent years. The Board expects to be able to collaborate with its counterparts in Australia, New Zealand and other countries that apply IFRSs on a "sector neutral" basis (that is, to all reporting entities, including NFPOs and public sector entities, even though the IFRSs are not designed for those sectors). The Board's established

processes will allow the views and concerns of the preparers and users of NFPOs' financial statements on the convergence changes to be addressed during the expected five-year transition period (see paragraphs 43-48).

83 When the changeover to IFRSs for public companies occurs, the Board expects that it will also have in place the separate set of standards for private businesses described in paragraphs 72-74. In developing those standards, the Board will consult with the not-for-profit sector to assess whether they could be applied to NFPOs, and whether it would be suitable to do so. The Board will then be in a position to decide whether all NFPOs should base their accounting after the changeover date on the IFRSs or whether some might base their accounting on the new standards for Canadian private businesses. In the latter case, the Board will need to consider how it might categorize various types of NFPOs and develop a definition of NFPOs that are "publicly accountable" and, thus, ineligible for using the standards developed for private businesses.

84 The Board will maintain standards that deal with the special circumstances of NFPOs, regardless of which accounting treatments are to be applied on issues common to both NFPOs and profit-oriented enterprises. That is, the Board will retain and improve the current standards in Sections 4400-4460 of the Handbook and develop any additional standards that are necessary for reporting by NFPOs. In doing so, the Board will take account of the fact that significant groups of NFPOs, such as universities and hospitals, are found in the public (government) sector and that public sector entities are significant sources of some NFPOs' funding and, thus, primary users of the financial statements. These NFPOs raise issues not encountered among profit-oriented enterprises (including government business enterprises). Accordingly, the Board will continue to co-operate with the Public Sector Accounting Board in addressing issues in the not-for-profit sector. However, the Board does not intend to change the current approach to dealing with transactions and circumstances common to both profit-oriented enterprises and NFPOs under which the same standards apply to both types of reporting entity.

85 A possible consequence of the Board's strategy for public companies is that, if the IASB were to expand its current mandate to include NFPOs, the Board would consider whether

to apply IFRSs on not-for-profit issues to Canadian NFPOs in place of the standards in Sections 4400-4460.

Maintaining Canada's standard-setting capability

86 The final strategy the Board proposes is as follows:

> Canada will continue to maintain its own standard-setting capability to carry out the strategies outlined above, although the roles, structures, processes and resources will evolve to match those strategies.

87 This strategy addresses the first question raised in the 2004 Invitation to Comment, which was designed to determine whether stakeholders see any benefit in Canada continuing to participate in setting accounting standards. The question deliberately did not ask whether Canada needs the current Board structure or processes or whether Canada should continue to determine the standards it will adopt. The question was intended to be broader and to elicit ideas about how standard setting might be done in the future in the context of the answers to the other questions posed in that Invitation to Comment.

Why Canada wants and needs a standard-setting capability

88 The responses to the 2004 Invitation to Comment indicate a very substantial consensus that, regardless of the positions taken on the other strategic issues, stakeholders want Canada to maintain a high-quality standard-setting capability. Those who advocate the eventual adoption of either IFRSs or US GAAP are willing to accept that the ultimate decision-making role in setting standards will be filled by the IASB or the FASB in all but exceptional cases. However, they still see a role for Canada in the process and a need for appropriate structures and adequate resources devoted to the process.

89 Some commentators wondered what a national standard setter would do in a global convergence model. Papers on this topic, developed by the Canadian and Australian boards, were presented to September 2004 meetings of the IASB and a number of national standard setters. The Canadian paper listed and discussed nine functions that a national standard setter might usefully carry out in a country that has adopted IFRSs:

(a) participating in the IASB's strategic planning, including setting project priorities;

(b) assisting with the standard-setting technical agenda by participating in project teams;

(c) advancing the research agenda by undertaking research projects;

(d) helping to address implementation and interpretation issues by identifying them and undertaking research in support of the International Financial Reporting Interpretations Committee;

(e) evaluating the effectiveness of standards (post-issuance reviews);

(f) promoting acceptance of IFRSs;

(g) assisting the IASB in communicating with constituents;

(h) co-ordinating educational activities with the IASB and facilitating national education programs; and

(i) developing future standard-setting talent.[27]

The Board is carrying out most of these functions currently in fulfilling its obligations to its partners in the liaison arrangement with the IASB and seven other national standard setters. The Board proposes that it continue doing so.

90 Respondents to the 2004 Invitation to Comment want Canada to have a strong voice in the international arena to protect Canadian interests, both by working to promote the highest possible quality for globally converged standards and by ensuring that Canadian circumstances are suitably addressed in those standards. Some also proposed that Canada play its usual international role of "honest broker" by resolving any tensions between the IASB and the FASB.

91 The Board believes that Canada needs a high-quality standard-setting capability for the following purposes, in addition to matters noted above:

(a) to develop and maintain standards for private businesses and NFPOs, under strategies discussed above, for an indefinite or long-term period;

---

[27] The Canadian and Australian discussion papers are both available on the IASB website at www.iasb.org/meetings/0409.asp. The IASB has subsequently developed a draft memorandum of understanding concerning its relationship with national standard setters, which is available at www.iasb.org/uploaded_files/documents/8_38_DraftMoUFeb2005.pdf.

(b) to promote and support IFRSs as the global standards benchmark as well as the successful functioning of the IASB as an institution, at least for the short-to-medium term;

(c) to deal with the transition to IFRSs in Canada, including dealing with “legacy” issues, for the transitional period only;

(d) to fill gaps in IFRSs when a particular subject on which the IASB has not yet developed a standard is of much higher priority for Canada than for the international community generally, possibly only for a limited period following the changeover date;

(e) to act as a mechanism for importing IFRSs, for the medium term or longer; and

(f) to act as a “centre of excellence” in accounting thought and practice to maintain and improve the quality of financial reporting in Canada and Canada’s contribution to international standard setting.

92 The role summarized in paragraph 91(e) is that of a facilitator in importing IFRSs into Canada. At least to begin with following completion of the transition for public company reporting, there will likely be no requirement for Canadian public companies to apply IFRSs other than through their inclusion in the Handbook. There will also be no other mechanism for making IFRSs applicable to NFPOs (until such time as the IASB may expand the scope of its standards). At least until all concerned are comfortable with the process for developing and importing IFRSs, Canada will need to retain the capability to manage the importation of IFRSs through its own due process. It may also be desirable to retain a basis for adding to IFRSs any application guidance needed to address Canadian circumstances.

Structure, processes and resources

93 The Board notes that its current makeup, as set out in its terms of reference, was established within the framework developed by the TFOSS and its membership has been selected with a view to carrying out its current strategies. A number of its processes were designed with current strategies in mind, and the resources available to it are those determined to be necessary to carrying out those strategies.

94 Some respondents to the 2004 Invitation to Comment proposed changes to current standard-setting arrangements, and changes may be necessary once a new strategic course has been set. The Board believes it is premature to entertain proposals on matters of structure, process and resources until it has determined its future strategies. At that time, when the objectives have been clearly identified, the Board will work with the AcSOC to ensure that the structures and processes are appropriate to meeting those objectives. It will also be possible to estimate the resources needed to achieve them.

Dealing with "standards overload"

95 The Board's proposed plan includes the following commitment to address change management issues:

> In carrying out these strategies, the Board proposes to pay particular attention to the practical limitations on the ability of the Canadian financial reporting system to cope with change. In other words, the Board will be particularly sensitive to the "standards overload" issue. Where change is determined to be necessary, the Board will take such steps as it can to assist affected parties in dealing with change through, for example, participating in the development of implementation aids and training programs.

96 While not a strategy itself, this commitment is critical to the acceptance of the strategies proposed and their subsequent implementation. The responses to the 2004 Invitation to Comment contained a very clear message that all aspects of the Canadian financial reporting system have been subject to considerable strain in recent years. Regardless of whether people are financial statement preparers, auditors or users, or whether they work in the public company, private business or not-for-profit sector, almost all have found it very difficult to stay on top of the changes affecting them.[28]

---

[28] These changes are identified and discussed in the Discussion Paper accompanying the 2004 Invitation to Comment. While it is widely accepted that change is necessary, particularly to address the weaknesses in the financial reporting system revealed by recent financial reporting failures (Enron et al.), the system has not had adequate resources to cope well with the amount of change.

97 Some change is necessary, including changes designed to alleviate some of the burdens imposed by current accounting standards. As the Introduction to the Handbook states:

> Accounting is not static. It has changed in the past and will continue to adapt to changes in economic or social conditions in the future.

The Board will need to place more emphasis on meeting the needs of certain groups that have not occupied its attention as much under its current strategies, such as the private business sector, the not-for-profit sector and financial statement users. Although sympathetic to those bearing the brunt of change, the Board sees no prospect that accounting standards will cease to change.

98 The increased pace of change in financial reporting requirements in Canada in recent years has resulted largely from the reactions to Enron and other financial reporting failures. People will need some time to adapt fully to various new requirements that have recently become effective or are about to become so, but the Board expects that the rate and extent of change will abate. Nevertheless, the timing of changes introduced in carrying out the Board's proposed strategies will need to be considered very carefully. The Board will monitor the implementation of its strategies to address any overload issues that may emerge.

99 One aspect of the Board's proposed plan is that there will no longer be a single Canadian GAAP for financial statement users, preparers and auditors to become familiar with, with the result that some people may need to learn more than one set of standards. This constitutes an element of overload for those so affected. However, the Board notes that this situation exists currently to some extent. It is also a natural consequence of the "one size does not necessarily fit all" strategy that is expected to provide relief to more people than those on whom it places an increased burden. The extent of difference between the various sets of standards that will be in use in Canada, and thus the burden of learning more than one set of standards, is dependent in part on the outcome of the proposed strategies and cannot be predicted in advance.

100 The strategies proposed in this draft plan are designed to achieve fundamental changes in standards without requiring an immediate, "big bang" change in accounting practices.

Some of the changes involve giving reporting entities choices and some involve lessening burdens. Some changes in standards may involve the application of different principles and concepts without requiring much change to accounting practices or systems, and without necessarily having much effect on reported financial results.

101 In introducing changes, the Board will take particular care to:

(a) communicate its activities fully to as broad an audience as possible;

(b) seek input from all affected stakeholder groups;

(c) express new requirements clearly and provide adequate explanations for them;

(d) provide a reasonable period between the issuance of requirements and their mandatory effective date, to permit entities to prepare for initial application (including additional time for entities other than public companies);

(e) introduce changes to standards less frequently by "batching" them up and introducing several changes together;

(f) develop implementation aids and assist others in developing them; and

(g) assist those charged with the education and professional development of accountants and financial statement users to develop programs to teach the new accounting requirements.

The Board will also provide input to the IASB and the FASB on change management issues such as those listed above in the development of new global standards that will apply to some Canadian reporting entities.

102 The Board will consider what implementation aids it is able to provide within the limits of its mandate and resources, taking advantage of all available methods of providing guidance to those who most need it. Guidance will focus on indicating how new requirements might affect various types of entities, particularly those less able to determine the effects for themselves. The Board will also encourage and support professional organizations and others in providing such guidance and in developing education programs. The strategies proposed above will require a considerable amount of professional development effort by all affected parties. Successful implementation of the proposed strategies will depend to a significant extent on educating accountants and financial statement users in the new standards.

Conclusion

103 This draft plan raises various matters that the Board believes significant in explaining the strategies proposed and how they were arrived at. The Board is seeking input on the strategies themselves but also welcomes comments on the additional background information and on issues that commentators foresee in applying the proposed strategies. Such comments may prove helpful to the Board in finalizing the strategies or in formulating implementation plans subsequently.

Appendix A

Timelines for Finalizing and Implementing the Strategies

Completion of the strategic plan	
Deadline for comments on the Invitation to Comment	July 31, 2005
Board review of comments	September 2005
AcSOC review of comments	October 2005
Board redeliberation of proposed strategies	November 2005 - January 2006
AcSOC discussion of draft final plan	February 2006
Board approval of final plan	March 2006
Implementation of the public company strategy	
Implementation of the plan commences	April 1, 2006
Development and publication of detailed work program for amending standards to conform with IFRSs	April - June 2006
Development of amended standards commences	July 2006
Checkpoint review	April - September 2008
Expected changeover to IFRSs	April 1, 2011
Implementation of the private business strategy	
Implementation of the plan commences	April 1, 2006
Exemption from Handbook standards for private businesses having no significant external stakeholders finalized	March 2007
Exemption from Handbook standards for private businesses having no significant external stakeholders becomes effective	April 1, 2008 or later
Research on financial reporting needs of private businesses with significant external stakeholders completed; Board decision on approach; development of standards commences	April 2008 - April 2009
Completion of standards for private businesses with significant external stakeholders	Uncertain

Appendix B

Which Standards Will Apply to Which Entities

Profit-oriented enterprises:

	US GAAP (to the extent permitted by competent authorities)	IFRSs	Canadian GAAP for non-publicly accountable enterprises	Standards not applicable
Public companies[1]	X	X		
Private businesses[2]		a	X	
Private businesses with no significant external stakeholders[3]		a	a	X

Not-for-profit organizations:

	IFRSs	Canadian GAAP for non-publicly accountable enterprises	Standards not applicable
	plus standards on issues unique to not-for-profit organizations		
Publicly accountable[4] organizations	X		
Non-publicly accountable[4] organizations	a	X	
Non-publicly accountable[4] organizations with no significant external stakeholders	a	a	X

[a] Available alternative.

[1] As described in paragraph 16.

[2] As described in paragraph 53.

[3] As discussed in paragraph 61.

[4] "Publicly accountable organizations" in the not-for-profit sector is a new concept in accounting standards that will require a clear definition. A definition could be based on the categorizations of "soliciting" and "non-soliciting" organizations under recently proposed federal legislation (Bill C-21) to establish a new Canada Not-for-Profit Corporations Act.