

Behind the Counter

GAAP, and IFRS

Now that the personal tax season has ended, we need to find out what's been happening in the accounting world outside of taxes. Canada and the US are well underway in their pursuit of International Financial Reporting Standards (IFRS). The implementation deadline in Canada is 2011. Standard setting in Canada has always been set by the Canadian Accounting Standards Board. These standards are printed in the CICA Handbook that designated accountants are required to use in their practices. The CICA Handbook includes Generally Accepted Accounting Principles (GAAP) as well as Generally Accepted Auditing Standards (GAAS).

Currently the UK and Europe operate under the International Accounting Standards (IAS) and the US operates under its own GAAP while Canada operates under its own GAAP. You can understand that if you have a company that has international offices, the differences in accounting rules can be overwhelming. The IFRS is a way of bringing all the different rules together, however there are several issues with the new standards. The original reports indicated that the impact will be mostly felt in the securities markets because the companies that are registered will need to comply with IFRS as a trading requirement on the Canadian and US stock exchanges. IFRS is a set of standards that attempts to include economic indicators in the financial statements, rather than historical indicators or principles. It has been said that less disclosure will be required under IFRS, so it may well turn out to be more of an investor beware situation. On the other front, securities regulators believe that this change will lead to higher quality financial reporting.

Currently, there is not a definition of a sole proprietorship within IFRS. The IFRS definition of small company refers to a company with at least 50 employees. It is currently unclear as to how sole proprietorships and other small businesses (as defined in Canada) will need to comply with the new standards. It has been indicated that the CICA handbook will be withdrawn and a new IFRS manual produced as well as a separate manual for Canadian small businesses that are not traded on the stock exchange, however, the jury is still out on the final verdict.

The biggest hurdle expected for Canadian companies is the requirement to report property plant and equipment at fair value, allowing revaluation every year. The requirement is that fair value be reasonably and justifiably estimated with reasonable certainty. For intangible assets such as patents or items that are not traded in an active market, it may be nearly impossible to determine fair value. Another area of difficulty would be rental properties where the owner might choose to use part of the property for personal purposes.

Some other changes will be the mandatory capitalization of interest on borrowed funds, construction contracts will only be recorded using the percentage of completion method or the cost plus method. Interest revenue will be calculated using the effective interest method so that premiums on a bond will become revenue earned.

Revenue and expense recognition will be based on changes in assets and liabilities so deferred revenues and charges will be eliminated. Asset impairments will need to be recognized immediately. Inventory values are limited to 3 types, materials purchased, process costs and finishing costs, ignoring warehouse costs for obsolete inventory. The rules for disclosing Earnings Per Share (EPS) have been reduced to only disclose EPS on Net Income, Fully Diluted Income and Operating Income.

The largest effect on firms that will be required to implement IFRS is that comparative statements will need to be prepared as if the firm had always used IFRS which means a lot of restating of prior year's financial statements. The first year of IFRS implementation by a firm also allows for a number of non-reversible choices that can be made for the presentation of financial statements that may have a significant impact on future financial statement results, therefore a lot of thought and analysis needs to be observed to make the correct decisions.

All this is quite exciting for the larger firms trading on the various stock exchanges, but for the small business owner, the effect of the new standards are not yet known.

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