



## Comparing Canadian GAAP and IFRS

Standard setters around the world have been working together for many years now, trying to reduce inconsistencies among accounting practices. Thus, many differences have been eliminated, or are in a process of convergence. To provide a better overview of what is going on, we look at the impact of this evolution on financial statements for Canadian companies over a period of time as opposed to a snapshot date. So the comparison addresses differences between Canadian standards and IFRS from 2000 to 2011.

### *Differences in the general presentation of financial statements*

Overall, the basic financial statements are the same: the balance sheet reveals assets, liabilities and equity; the income statement presents revenues and expenses; the cash flow statement is broken down into operating, investing and financing activities. But that being said, there are some differences in the content.

The main sections of a balance sheet are the same, but there is a difference in the practice of ranking that makes some IFRS-related statements look different. The Canadian practice consists of presenting assets in order of liquidity, from the most to the least liquid (cash is the very first item), and it's the same on the other side of the balance sheet, where liabilities come first followed by equity. IFRS permit this ranking, but an alternative can also be used — ranking based on a reverse-liquidity order (non-current assets presented before current and equity shown before liabilities). This style is so widely used, it's worth noting, although Canadian organizations will not be forced to apply it.

Still in the balance sheet, minority interest (called non-controlling interest under Canadian GAAP) arising from consolidation is part of shareholders' equity under IFRS, while it's excluded from it in Canadian GAAP.

The *income statement* for IFRS presents revenues and expenses similarly to Canadian GAAP, but doesn't allow for separate presentation of extraordinary items. The net income or profit (synonymous terms referring to the bottom line of the income statement) under IFRS is calculated to include profit pertaining to all shareholders, breaking it down separately into two shares, one for the equity holders of the parent company (accumulating in retained earnings of the balance sheet) and one for minority interest (accumulating in a separate minority interest account in the shareholders' equity of the balance sheet).

The *cash flow statement* includes the same three categories: operating, investing and financing. But there are differences under IFRS: interest paid can be presented in operating or financing activities; interest and dividends received can be presented in operating or investing. All interest and dividends are usually presented in operating activities in Canadian GAAP.

In addition to the three financial statements above, there is normally some other equity-related statements that are pre-sented and a number of formats used in practice. Up to 2006, the *statement of retained earnings* was required under Canadian GAAP while a more global approach is used by IFRS. The IFRS approach requires a reconciliation of equity as a whole, including share capital, retained earnings, reserves and minority interest.

Also, an additional disclosure named *statement of recognised income and expenses* is required by IFRS, showing the total income and expenses of the period, combining profit from the income statement and other gains and losses that affect equity through reserve or other accounts (bypassing income statement and retained earnings). Note that this additional disclosure isn't a reconciliation, as it shows the period information only; it doesn't include beginning and ending balances. It can be presented in various ways: in a separate *statement of recognised income and expenses* or in a sub-part of the *statement of changes in equity*. Canadian GAAP changed to this IFRS approach in October 2006 for public companies (October 2007 for non-public), except for a few points: *minority interest* is still outside equity and named *noncontrolling interest*; *reserves* are replaced by *other comprehensive income*; the *statement of recognised income and expenses* is entitled *statement of comprehensive income*.

#### *Differences in asset valuation*

Basically, all assets have been measured at cost, or at amortized cost, for many years under GAAP around the world; historical cost is a reliable value that is objective, accurate and verifiable. But the historical cost can be passed over in several situations now. In many situations, there's no difference between IFRS and Canadian GAAP. For instance, in impairment tests, losses in value are recognized for most assets under both IFRS and Canadian GAAP. Some differences exist in detailed application, but the concept is the same: losses in value are recognized immediately in the income statement when fair value drops below book value. However, reversing an impairment loss — when the value of an asset recovers subsequently — is allowed by IFRS for assets other than goodwill; this isn't permitted with Canadian GAAP.

In the case of financial instruments, accounting standards have converged significantly. Now, many financial instruments are measured at fair value. For instance, financial instruments held-for-trading, those available-for-sale and basically all derivatives are measured at fair value in both IFRS and Canadian GAAP.

Transaction costs on other than held-for-trading instruments are treated differently, however. Under IFRS, these costs must be included in the initial book value of the instrument. Under Canadian GAAP, the company can choose between expensing or capitalizing them.

One important difference in asset valuation that will arise from IFRS is the possibility of revaluing long-lived assets at fair value. This practice, not permitted in Canadian standards (except in the context of push-down accounting)<sup>1</sup>, allows companies to revalue tangible assets when their fair value can be measured reliably, and intangible assets when market-based evidence of fair value exists. Gains on revaluation are normally allocated to a revaluation surplus (or reserve) directly into equity, unless they reverse an amount previously recognized in the income statement (such as reversing an impairment loss previously recorded).

Canadian GAAP and IFRS also diverge in joint venture investments. Under Canadian GAAP, all joint ventures are consolidated using the proportionate consolidation method. Under IFRS, joint ventures can be consolidated proportionally, but another treatment is possible — the equity method. However, IFRS is considering removing the proportionate consolidation option to converge with U.S. rules by 2008.

Finally, IFRS allow a special treatment for non-monetary assets (and non-monetary liabilities) that are denominated in a functional currency when there is hyperinflation in the economy. IFRS generally consider that an economy is hyperinflationary when the cumulative inflation rate over three years approaches or exceeds 100%. In that case, non-monetary items are restated to their current value using a general price index. The impact of this restatement is that non-monetary assets and liabilities are adjusted to reflect changes in the general purchasing power. The gain or loss resulting from the change in the purchasing power of the monetary position is included in net income. There is no similar standard in Canada.

#### *Differences in liability accounting*

Although long-term liabilities may be presented before current (a possibility, not a requirement), most liability items are treated similarly in the two standards, except for some detailed applications. Off balance sheet financing is addressed in both sets of rules, including pension accounting, finance leases (capital leases in Canadian GAAP), derivatives in unfavourable position and special purpose entities (variable interest entities).

A few differences, however, may be noted in deferred income tax. First, the terminology used in Canada is currently "future income tax." Second, all amounts of deferred income tax are presented as non-current under IFRS, while some are considered short-term in Canadian GAAP and, therefore, presented in current liabilities (or current assets when applicable). These differences should be eliminated by 2009.

#### *Differences in equity accounts*

Equity accounts have been discussed above. The equity section under IFRS includes the following:

- Four major categories: share capital, retained earnings, reserves, minority interest;
- Profit from income statement accumulates in retained earnings;
- Retained earnings are reduced by dividends;
- Share of profit pertaining to minority shareholders accumulates in an equity account named *minority interest*; and

- Gains and losses that are recognized but not yet in the income statement accumulate in reserves and minority interest when applicable (such as revaluation increases and decreases; particular foreign exchange differences; gains/losses under eligible hedging strategies; and gains/losses on remeasuring available-for-sale financial assets).

The current Canadian treatment of equity is mainly converged with IFRS, except that the reserves are in an account called other comprehensive income (OCI), and minority interest isn't yet part of equity, nor is it measured at fair value on the date that subsidiaries are acquired. Accounting for minority interest in Canada is expected to converge with IFRS by 2009.

#### *Differences in accounting for revenues*

There are many situations in which IFRS differ from Canadian GAAP in application, but the overall logic is similar. Revenue is recognized when the entity has transferred to the buyer the significant risks and rewards associated with the goods sold. And they should be measured at the fair value of the consideration received or receivable unless the amount can't be measured reliably.

When services are rendered or contracts are long-term, the revenue shall be recognized by reference to the stage of completion under IFRS. This method (percentage-of-completion) is accepted by Canadian GAAP which also permit the use of the completed-contract method, allowing companies to delay the recognition of revenue (and related expenses) in the income statement until completion of contract. IFRS prohibit the use of the completed-contract method.

IASB is currently working on a project with the US on revenue recognition. In this project, it's assumed that revenue should be the result of changes in assets and liabilities rather than a consequence of the occurrence of critical events.

#### *Differences in accounting for expenses*

Here again, there are many situations where the standards differ at the application level, but overall the logic is similar. Basically, most expenses should be recognized in the income statement at the same time as the revenues that are generated from them.

Among the differences, the last-in-first-out (LIFO) method of accounting for cost of goods sold is not permitted by IFRS and should be prohibited in Canada by 2008.

Also, a change in the depreciation (or amortization) method for tangible or intangible assets with a definite useful life is considered a change in estimate under IFRS. Accordingly, the accounting treatment is prospective. This is a departure from the Canadian treatment that was applied until 2006, which considered this a change in accounting policy with retroactive application. A revised Canadian standard for accounting changes has just been adopted and converges with IFRS. It has to be applied from January 1st, 2007.

#### *Differences in other gains and losses*

Under Canadian GAAP, certain non-repetitive gains and losses can be presented separately at the bottom of the income statement, net of tax, and named extraordinary items. They must not be typical of normal business activities and should not depend primarily on decisions by management or owners. This special presentation makes it clear that extraordinary items, while being part of the income statement, are dissociated from normal operations. IFRS prohibit the use of extraordinary items either on the face of the income statement or in the notes. Therefore, such items aren't dissociated from normal operations.

Another area in which Canadian GAAP have been severely different from IFRS is in foreign currency translation. Although the standards are mainly converged now, the Canadian practice applied up to 2002 required foreign exchange gains and losses under the temporal method to be deferred and amortized in the income statement over the duration of the underlying monetary items — allowing companies to “smooth” income. The revised treatment (which is applied by IFRS, Canadian GAAP and also in the U.S.) is to include all exchange gains and losses immediately in the income statement, except those from the current rate method and some other from eligible hedging strategies.

As discussed above, accounting for financial instruments has significantly evolved in recent years. Accordingly, the accounting treatment of most gains and losses has pretty much converged now: those on held-for-trading instruments are included immediately in the income statement; those on available-for-sale instruments are allocated to equity (in reserves or OCI) until realized, at which time they are transferred to the income statement. One difference arises, however, from the combination of financial instruments and foreign currency accounting for available-for-sale instruments: under IFRS, all foreign exchange gains and losses are immediately allocated to the income statement, including those on available-for-sale instruments; under Canadian GAAP, these latter exchange gains and losses are allocated to OCI.

For some companies, IFRS are going to provoke a revolution in their specific accounting practices. While the presentation of financial statements is quite similar on the conceptual level, some differences may become very important for application. Among the differences discussed in this paper, some are directly visible on financial statements and others affect measurement. In particular, the equity section is presented differently and includes reserves and minority interest. Also, the special treatment of extraordinary items presently allowed in Canada isn't permitted in IFRS. For measurement issues, differences arise in areas such as fair-value accounting for long-lived assets, financial instruments and hyperinflation.