

GAAP for private business or IFRS — what's the best choice for you?

A Grant Thornton article for privately held business

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While the global economic crisis has taken centre stage for many private business owners, another issue is sneaking up in the wings. New international financial reporting standards, or IFRS, will take effect in Canada on January 1, 2011.

While adopting these new standards is optional for private companies, owners of larger privately held businesses face a difficult choice. The new standards may provide a competitive advantage to private companies, especially with respect to access to capital. On the other hand, the direct and indirect cost of changing to IFRS can be quite significant. With the effective date looming, private company owners must decide soon whether or not to adopt IFRS to ensure a smooth transition.

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Creating a common language

The switch to IFRS began long before recent economic events highlighted concerns for more financial transparency. In 1996, the International Accounting Standards Board recognized the need to standardize accounting—the language of the international business world—and introduced IFRS. The goal is to provide one set of understandable international financial reporting standards that improve comparability and transparency.

When Canadian generally accepted accounting principles, or GAAP, converge with IFRS for public companies, we will join more than 100 countries that use or are preparing to adopt the new standards. These include many Eurozone countries, Australia, Japan, China and India. The Securities and Exchange Commission is considering plans to make IFRS mandatory for US public companies commencing in 2014.

In Canada, publicly accountable companies must make the switch to IFRS. Private companies, however, face a choice. They can either adopt IFRS or they can migrate to the new GAAP for privately held businesses. This emerging standard will act as a more simplified form of GAAP for private companies. Either way, the existing GAAP standard under which both private and public companies currently report will be phased out,

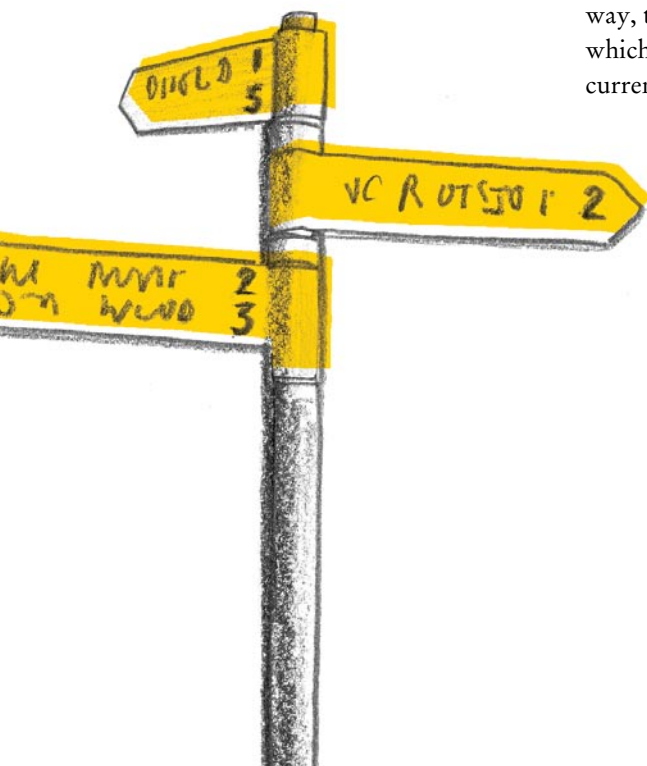
meaning private companies can't simply sit on the sidelines. Over the next several months, these businesses will have to choose which accounting standard they would prefer to adopt.

Is simpler better?

With so many imperative decisions on the horizon, privately held business owners may be tempted to default to the simplest route when determining which accounting standards to adopt. For smaller private companies that rely on term financing or have little or no exposure to global markets, this in fact may be the wisest decision. But for large private enterprises, or small companies with aggressive growth plans, simpler may not be better.

As with any organizational shift, the devil is in the details. These are best dealt with on a company-by-company basis. Before getting into a line-by-line analysis of the impact of IFRS, you should keep an overriding consideration in mind—the needs of your financial statement readers. First and foremost, financial statements are a communication tool. That means the statements must be understandable, relevant, reliable and comparable to be effective.

As a business changes, so does the audience for its financial statements. If you're not speaking the right financial language to new stakeholders, your company could suddenly find itself at a significant disadvantage.



Maintaining competitive advantage

Consider, for instance, the likelihood of your company seeking to expand globally or being offered an international growth opportunity, either directly or in partnership with a foreign firm. As countries around the world transition to IFRS, you may find yourself at a competitive disadvantage in negotiations if your financial statements are not comparable to others or easily understood by your potential partners.

Similarly, as your business grows, you may need to attract both foreign suppliers and customers. If you choose not to adopt IFRS, your potential suppliers and customers may opt to do business with another company whose financial statements are more understandable and transparent to them.

Conventional wisdom has it that bankers don't rely on the financial statements of a privately held business. However, what if your banker needs to compare your non-IFRS statements with statements prepared according to IFRS for a large loan or syndicated financing application? Getting this approval, which is tough enough at the best of times, could be made more difficult by differences in disclosure and transparency.

Finally, the natural path for many successful private companies is to eventually seek equity for growth and expansion through an initial public offering. You must convert to IFRS if you go this route. Private companies that don't convert to IFRS during this initial adoption timeframe will be required to retroactively prepare financial statements according to these standards when preparing a public offering. This will be an especially onerous and costly task, adding to the already complicated process of going public.

Making an informed choice

The temptation for private business owners accustomed to running lean operations will be to avoid the cost of converting to IFRS. This is understandable. After all, the transition to IFRS involves more than simply changing accounting practices. You will need to consider business issues such as staff retraining, information systems, internal controls and the terms of contracts involving financial measures. For these reasons, and more, IFRS may not be the right standard for your company.



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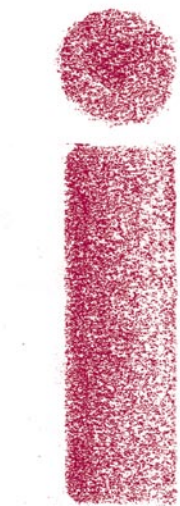
However, making a smart choice, one that will provide long-term benefits for your company, shouldn't be based solely on the cost of adopting IFRS. When weighing the advantages and disadvantages, you'll need to answer questions such as these:

- Is external financing critical to the growth of your business?
- Do you compete against public companies for access to credit and financing for your business?
- Do you plan to expand globally?
- Does your business compete against or partner with international or public companies?
- If you rely on financial benchmarking, will you be able to make accurate comparisons to others in your industry?
- Do you have the internal resources to convert to IFRS and keep up to date?

The January 1, 2011 implementation date for IFRS may seem a long way off. But if you're a private business owner, you don't want to be blindsided by this change.

The trick is to assess your needs sooner rather than later. That way, you'll make the best use of your human and financial resources whether or not you decide to make the switch to IFRS.

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