Accounting Standards Board

Consultation Paper I

Exploring Scalability in Canada

March 2023

This Consultation Paper closes for comments on July 31, 2023.

The AcSB welcomes feedback from any interested party on any or all the questions posed in this Consultation Paper.

You can provide feedback to the AcSB on the proposals in a variety of ways:

- Participate in our Connect.FRASCanada.ca survey.
- Connect directly with the AcSB by attending a discussion session on this Consultation Paper. Session dates and registration information will be posted to the Scaling the Standards project page.
- Write a response letter and upload it via our online form. Response letters can be addressed to:

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Accounting Standards Board
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Toronto, Ontario M5V 3H2
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Note: Response letters will be posted online when this Consultation Paper closes for comment. Confidentiality can be requested when uploading letters via the online form.

Helpful tips when participating in a consultation:

- Comments are most helpful if they relate to a specific paragraph or group of paragraphs found in the Consultation Paper.
- If a potential issue in the proposals is identified, it is encouraged to clearly explain the issue and include a suggested alternative, supported by specific reasoning.
- It is important to note that the AcSB does not expect respondents to reply to every single question posed – only those that interested parties feel they can or should respond to.

AcSB
Accounting
Standards Board

The Accounting Standards Board (AcSB) is an independent body with the authority to establish accounting standards for use by all Canadian entities outside the public sector. For further details on the AcSB, please visit our website.

The AcSB's 2022-2027 Strategic Plan sets out the broad objectives that will guide the Board in achieving its public interest mandate. The Board decided on these objectives after extensive stakeholder consultation. Implementation plans to execute these strategies will be described in its annual plans.

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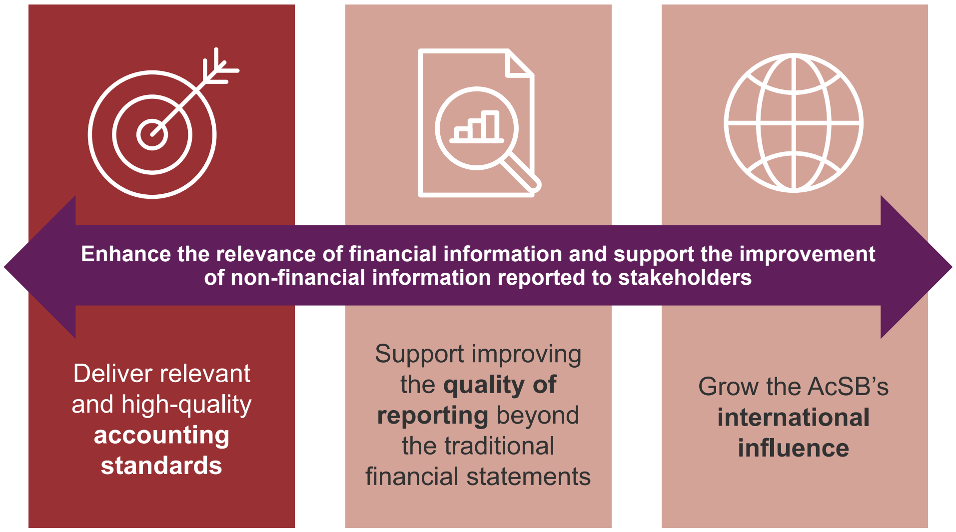
OVERVIEW

What is the current landscape?

1. In Canada, accounting standards for all entities outside the public sector are issued by the Canadian Accounting Standards Board (AcSB). More than 10 years ago, the AcSB established four parts of the CPA Canada Handbook – Accounting (the Handbook):

2. Since the establishment of the four Parts of the Handbook, Canada's financial reporting landscape has evolved considerably. This includes extensive change in IFRS Accounting Standards since their initial adoption in Canada (which, for most publicly accountable enterprises, occurred for fiscal years beginning on or after January 1, 2011). The reporting needs of private enterprises, NFPOs and pension plans have also changed, and the AcSB is aware that there is significant diversity in each of these categories in terms of entities' size and complexity. Accordingly, the information needs of financial statement users may vary. Investors and other stakeholders are also demanding more transparency and decision-useful information, beyond what is currently available in the traditional financial statements.

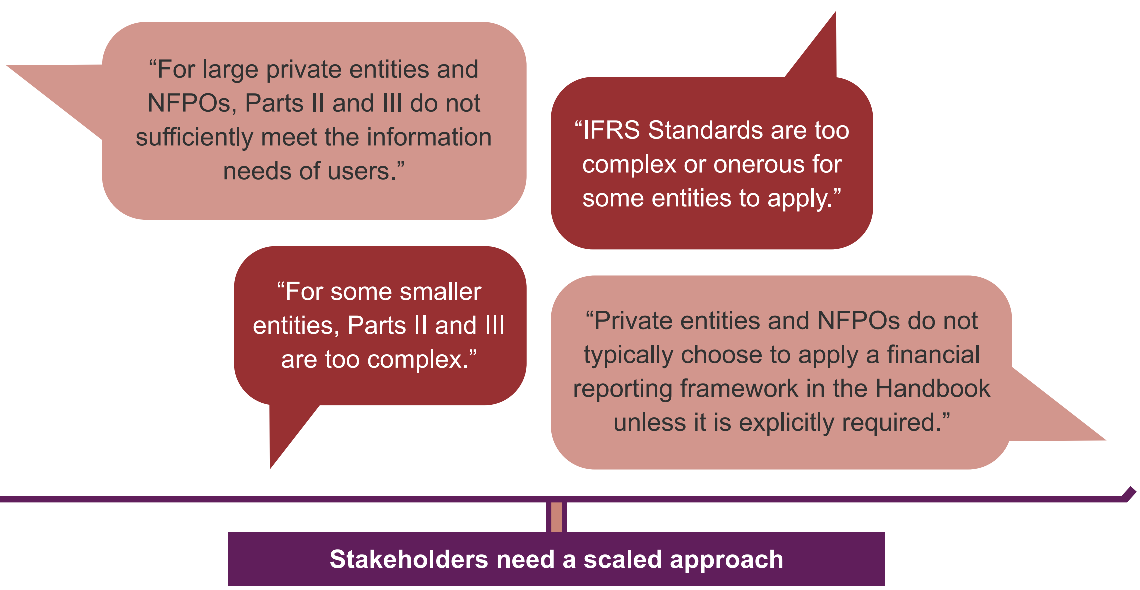
3. The AcSB's 2022-2027 Strategic Plan identified three core strategies, all aimed at enhancing the relevance of financial information provided to Canadian stakeholders:



As part of its core strategy of *delivering relevant and high-quality accounting standards*, the AcSB committed to exploring scaling the standards for non-listed entities to better meet stakeholders' different reporting needs.[1]

What issues have stakeholders raised?

4. Through preliminary research on this project, the AcSB has heard the following key concerns from stakeholders:



1 "Non-listed entities" refers to entities other than those that have issued, or are in the process of issuing, debt or equity instruments that are or will be outstanding and traded in a public market. As part of this project, the AcSB is focusing only on non-listed entities that currently meet the definition of a publicly accountable enterprise and apply IFRS Accounting Standards, because the financial reporting requirements of listed entities are under the jurisdiction of the Canadian Securities Administrators.

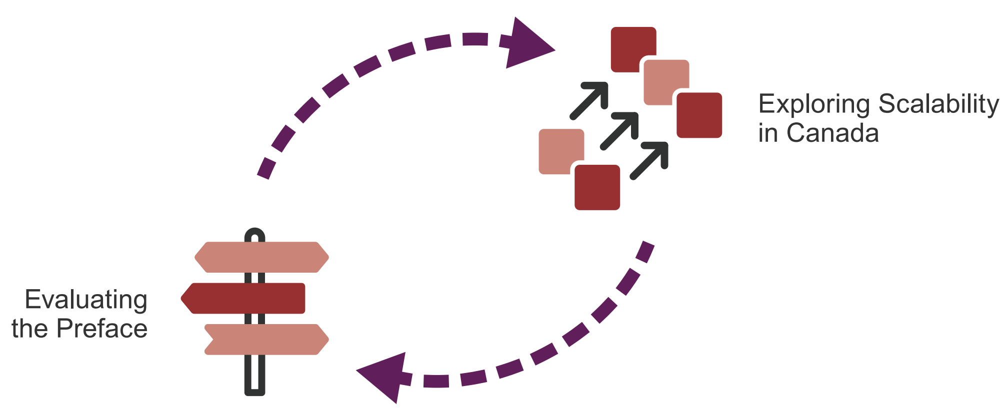
> **Question 1:** Do you agree with the summarized issues above? If not, why not? Are there any additional issues with the current financial reporting frameworks in Canada that the AcSB has not identified? If so, what are they, and how do you think the Board could address them as part of its project on scaling the standards?

PURPOSE OF THIS CONSULTATION PAPER

5. The AcSB will undertake activities, including consulting with stakeholders, to explore scaling the existing accounting frameworks to better meet the reporting needs of non-listed Canadian entities and the information needs of their financial statement users. This Consultation Paper aims to obtain broad input and data from private enterprise, NFPO and pension plan stakeholders, including financial statement preparers, users, and practitioners on the current key issues and potential solutions related to scaling the standards.

6. The AcSB is concurrently undertaking a project on evaluating the current Preface to the Handbook, to assess whether the applicability of each framework to each category of reporting entity meets stakeholders' needs. Although this Consultation Paper focuses primarily on the Board's Scaling the Standards project, there is an intrinsic link between this project and the Board's Evaluating the Preface project. Regardless of whether changes are needed to the reporting category definitions used or to the applicability requirements in place, both are important to think about in conjunction with the scalability options under consideration. If scaling is added to certain Parts of the Handbook, this may either alleviate existing concerns with the Preface or create new issues with the Preface that would need to be considered. Accordingly, while this Consultation Paper focuses on scalability, the Board also welcomes any feedback or concerns that stakeholders have on the Preface at this time.

7. The AcSB knows that implementing changes (if needed) to the current Preface and exploring scalability solutions with Canadian stakeholders will take time. So, this Consultation Paper represents only the first phase of consultation on the Scaling the Standards and Evaluating the Preface projects. It is important for the Board to first hear more from Canadian stakeholders on the issues they encounter and the potential options and solutions they would support to address these concerns. This feedback and data will help the Board decide on the projects' direction.



SCALING THE STANDARDS

What is scalability?

8. When it discusses scalability, the AcSB considers how the existing frameworks in the Handbook could change to better meet the needs of stakeholders in entities of all sizes. Such changes may include providing entities with choices within the existing domestic standards (e.g., providing accounting policy choices or limiting the required level of disclosures for some entities). Alternatively, scalability can refer to adding more Parts to the Handbook (e.g., adding a separate Handbook part that aims to better meet the needs of smaller private enterprises and/or NFPOs). In practice, "scalability" is often referred to as "tiering."

9. The AcSB has heard in the initial research phase of this project, particularly from financial statement users, that scalability in financial reporting for private enterprises and NFPOs could be helpful as it may simplify financial reporting for smaller and medium-sized entities. That said, the Board has also heard that additional tiers may be cumbersome, requiring stakeholders to understand another financial reporting framework.

Demonstrating scalability in the United Kingdom:

The domestic financial reporting framework in the United Kingdom is made up of five different regimes:

1. **FRS 101** – Reduced disclosure framework;
2. **FRS 102** – Financial Reporting Standard applicable in the UK and Republic of Ireland;
3. **FRS 102 Paragraphs 1.8 to 1.13** – Reduced disclosures for subsidiaries and ultimate parents;
4. **FRS 102 Section 1A** – Small entities regime; and
5. **FRS 105 –** Micro-entities regime.

Public companies in the UK are required to apply IFRS Accounting Standards. Whether an entity is eligible to apply a particular regime depends on several factors, including the type of financial statements prepared (i.e., individual or group), size thresholds, and entity type. When a choice of regime exists, entities consider which regime is most appropriate depending on the resources available and their financial statement users' information needs.[2]

2 Financial Reporting Council (FRC), Standards Overview, "Overview of the financial reporting framework," FRC.

Scalability in other jurisdictions

10. The AcSB conducted research on other jurisdictions that have tiered financial reporting frameworks. The Board identified and focused on jurisdictions with similar quantitative and qualitative characteristics to Canada, such as, but not limited to, relative market size, global competitiveness, social frameworks, economic advancement, and level of trade with Canada. This research sought to identify how other jurisdictions approach scalability and identify opportunities to leverage ideas or approaches used elsewhere.

    Review our Scalability in Other Jurisdictions research for a summary on scalability initiatives implemented in other jurisdictions, including the applicability of each framework to different types of entities and tiering that exists within each framework.

Question 2: Do you think the AcSB should pursue scaling alternatives to the current accounting frameworks included within the Handbook? Why or why not?

POTENTIAL SCALABILITY SOLUTIONS IDENTIFIED SO FAR

11. The AcSB has identified several potential ways to add scalability into the existing Handbook. The Board seeks stakeholder views on the potential solutions' viability and completeness. A key consideration is whether the potential solutions strike the appropriate balance between simplifying the accounting requirements for small and medium-sized entities (and the associated costs of applying those requirements) while ensuring their financial statements remain useful to their stakeholders.

12. The AcSB acknowledges that there is no consistent definition of what constitutes a small and/or medium-sized entity in Canada, and stakeholders may have diverse views on how entities should be categorized. In future stages of this project, the Board will consider how entities would be classified, including establishing thresholds for any tiering added to the existing Handbook. The Board will consult with stakeholders on this matter at a later date.

1 Tiering within the existing Part II and Part III frameworks – Simplified recognition and measurement in selected standards

13. Through initial research and discussions with stakeholders, the AcSB observed that some smaller private entities and NFPOs find some Part II or Part III requirements too onerous to apply and unnecessary based on their stakeholders' information needs. In many cases, the financial statement users are known to the entity and often have intimate knowledge of it. In addition, some users of Parts II and III financial statements have the capability, by contractual right or otherwise, to obtain additional information from management.

14. The AcSB noted one potential solution is to provide tiering within the existing Parts II and III frameworks for entities that meet certain requirements. This potential solution is similar to the introduction of a new small-entity framework (discussed in paragraphs 25-27 below) but reporting options could be selected on a topic-by-topic basis for entities that meet certain requirements. This would not affect existing accounting policy choices currently provided to all entities in Parts II and III; instead, additional accounting policy choices would be provided only to entities that qualify. By providing for simplified recognition and measurement options in selected standards, preliminary stakeholder feedback indicates this might result in more relevant information for those qualifying entities.

Demonstrating tiering within a framework:

An example of existing tiering developed by the AcSB for recognition and measurement is found in Part III.

Section 4433, *Tangible Capital Assets Held by Not-for-Profit Organizations*, allows organizations with consolidated annual revenues for the current and preceding period less than $500,000, to forgo capitalization of tangible capital assets. This is an accounting policy choice provided to organizations who meet the size test set out in this standard.

Question 3: If the AcSB were to pursue tiering within **Part II**, which standards have **recognition and measurement** requirements that are complex for some entities to apply? What opportunities exist to simplify the **recognition and measurement** requirements in these standards while still providing useful information to financial statement users?

Question 4: If the AcSB were to pursue tiering within **Part III**, which standards have **recognition and measurement** requirements that are complex for some NFPOs to apply? What opportunities exist to simplify the **recognition and measurement** requirements in these standards while still providing useful information to financial statement users?

2 Tiering within existing Part II and Part III frameworks – Reduced disclosure requirements

15. Similar to the feedback regarding simplified recognition and measurement requirements in selected standards, the AcSB also heard that reduced disclosure requirements might help small private entities and NFPOs apply Part II and Part III without reducing the overall usefulness of the financial statements.

16. The benefit of this potential solution is that it would maintain the comparability of the primary financial statements (i.e., statement of operations, statement of financial position, cash flow statement and statement of changes in equity/net assets) across all entities that apply Part II or III because recognition and measurement requirements would remain consistent. For entities that qualify, this would reduce the cost of preparing disclosures.

Question 5: If the AcSB were to pursue tiering within **Part II**, which standards have **disclosure** requirements that are complex for some entities to apply? What opportunities exist to simplify the **disclosure** requirements in these standards while still providing useful information to financial statement users?

Question 6: If the AcSB were to pursue tiering within **Part III**, which standards have **disclosure** requirements that are complex for some entities to apply? What opportunities exist to simplify the **disclosure** requirements in these standards while still providing useful information to financial statement users?

3 Intermediary accounting framework option between IFRS Accounting Standards and Parts II and III

17. In reviewing the potential scalability solutions, the AcSB considered whether there is a need for a framework between IFRS Accounting Standards and Parts II and III. Such a framework would be aimed at entities for which full IFRS Accounting Standards would be too onerous, but Part II or III would not be sufficient.

Research on liquidity events

18. In exploring this potential solution, the AcSB considered the financial reporting requirements of entities preparing for liquidity events, including initial public offerings (IPOs), mergers and acquisitions, and other financing arrangements. In many cases, entities undertaking these activities are required to produce IFRS Accounting Standards-compliant financial statements. The Board thinks that entities considering a liquidity event in the future may find a “stepping-

stone" framework useful, allowing them to prepare to eventually adopt IFRS Accounting Standards without the full rigour of such standards in the near term. The Board conducted research on IPO activities to better understand the challenges in this area and the potential need for an intermediary framework.

19. This research provided limited insight into the financial reporting challenges faced by entities transitioning from ASPE to IFRS Accounting Standards. After its discussions with stakeholders, the AcSB learned that in many "go-public" scenarios, the entity had been applying IFRS Accounting Standards or U.S. GAAP for several years. Often, the entity selected these frameworks in anticipation of going public or based on the needs of existing investors.

20. Although stakeholders did not alert the AcSB to any significant challenges with adopting IFRS Accounting Standards, in many cases, entities hired external accounting advisors to assist with the more complex accounting requirements. To the Board, this potentially signals that the financial reporting requirements of going public could be time-consuming and demanding on an entity's resources. The success of many liquidity events is tied to an entity's ability to execute the transaction in a timely way. Limiting these challenges by permitting entities to adopt an intermediary accounting framework could be a solution for private enterprises looking to go-public or undertake another type of liquidity event.

Question 7: How common is it for entities to transition from ASPE to IFRS Accounting Standards? Other than preparing for an IPO or other liquidity event, what drives an entity to make this transition? What challenges do entities face with this transition? Did the time taken to comply with financial reporting requirements in IFRS Accounting Standards result in any negative consequences or missed opportunities for entities? What opportunities exist to make the process to transition from ASPE to IFRS Accounting Standards easier and less time-consuming?

Question 8: If the AcSB were to introduce an intermediary option between ASPE and IFRS Accounting Standards, which elements of Parts I and II should be included in this accounting framework? Which elements of Part I are beneficial to include, and which are too onerous to apply?

Question 9: If the AcSB were to introduce an intermediary option between accounting standards for NFPOs and IFRS Accounting Standards, which elements of Parts I and III should be included in this accounting framework? Which elements of Part I are beneficial to include, and which are too onerous to apply?

IFRS for SMEs Accounting Standard

21. In considering options for this intermediary framework, the AcSB discussed the *IFRS for SMEs* Accounting Standard as a potential option.

22. As part of the research on scalability, the AcSB refreshed its consideration on the appropriateness of the *IFRS for SMEs* Accounting Standard for Canadian stakeholders. At the moment, the *IFRS for SMEs* Accounting Standard is not commonly used in Canada, and based on the Board's outreach, there remains limited interest in Canada for the standard.

23. Through discussions with IASB staff, the AcSB noted that the *IFRS for SMEs* Accounting Standard is typically applied by private entities in emerging markets. Further, as a market develops, the jurisdiction typically works toward drafting its own set of domestic standards for private enterprises. While not entirely clear, this outcome is likely to provide a financial reporting solution that best aligns to the local legal and regulatory frameworks.

24. Considering the information about the current applicability of the *IFRS for SMEs* Accounting Standard in Canada, the AcSB thinks that the standard would not meet the needs of Canadian stakeholders.

Question 10: Do you agree with the AcSB's assessment that the *IFRS for SMEs* Accounting Standard would not meet the needs of Canadian stakeholders? If not, why?

What is *IFRS for SMEs*?

IFRS for SMEs

Developed by the IASB to address financial reporting needs of entities without public accountability.

- First edition of this framework was issued in 2009.
- Based on full IFRS Accounting Standards, with simplifications to reflect financial reporting needs of SMEs.

Why it was not adopted in Canada?

The AcSB considered adopting this framework along with IFRS in 2011.

- Developed ASPE instead because Canadian stakeholders were concerned that several technical elements would not be suitable in Canada.

4 Introduction of a new framework for small entities

25. Through its research, the AcSB has sought to understand the extent to which private enterprises and NFPOs apply the existing standards in the Handbook. While information on the application of accounting standards is not readily available, the Board is aware that there are a significant number of small private enterprises and NFPOs in Canada. Through discussions with the AcSB's Private Enterprise Advisory Committee, Not-for-Profit Advisory Committee, and other stakeholders, the Board is aware that Part II and Part III standards remain too complex for many entities. Based on the Board's research, approximately 75 percent[3] of private enterprises in Canada and 90 percent[4] of charities have fewer than 10 employees.

3 Statistics Canada. Table 33-10-0214-01 Canadian Business Counts, with employees, June 2019 www150.statcan.gc.ca/t1/tbl1/en/cv.action?pid=3310021401.

4 CharityCan, T3010 data from 2016. The AcSB notes that this does not reflect the whole NFPO sector, as charities represent only a portion of all NFPOs.

26. Private enterprises and NFPOs in Canada often only apply accounting standards when required. In certain jurisdictions in Canada, the law requires that NFPOs that exceed certain size thresholds prepare audited or reviewed financial statements and apply Part III standards. For private enterprises, the AcSB understands that financial statements in accordance with Part II are often only prepared if required by a funder or another party, or because of regulatory or legal requirements that exist only for certain entities or sectors.

27. Stakeholders have informed the AcSB that introducing a simplified accounting framework might help increase the usefulness of financial statements and the comparability of information among entities. Further, the Board heard from financial statement user members of the Private Enterprise Advisory Committee that creating a simplified financial reporting framework could be beneficial as it would standardize reporting practice from the current variations of tax basis, cash basis and modified accrual basis (i.e., some accruals are made but not all). Similarly, the Board is aware that a new standard for practitioners who provide compilation engagements became effective for compiled financial information for periods ending on or after December 14, 2021. This new standard requires disclosure of the basis of accounting selected to prepare the financial information. A simplified accounting framework applicable to small entities may help some entities apply this requirement.

Question 11: If the AcSB were to develop a new framework for small entities to apply, what aspects of existing Part II and/or Part III would be helpful to retain? Are there additional factors or matters the Board should consider in its discussion of this potential new framework?

In summary, the AcSB has identified four potential solutions to achieve scalability in the Handbook:

1. Tiering within the existing Part II and Part III frameworks – Simplified recognition and measurement in selected standards
2. Tiering within the existing Part II and Part III frameworks – Reduced disclosure requirements
3. Intermediary accounting framework option between IFRS Accounting Standards and Parts II and III
4. Introduction of a new framework for small entities

Question 12: Which scalability solutions proposed by the AcSB do you think provide the greatest benefit to stakeholders, and why?

Question 13: Are there any other scalability solutions that you think the AcSB should consider?

Question 14: Which, if any, of the proposed scalability solutions do you think the AcSB should not pursue, and why?