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Short Article: Does the Canadian Way Add Up?

By: David Milstead

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Nation wins praise for switching to international accounting standards

Executive Summary

Canada has stopped requiring its companies to report their results using Generally Accepted Accounting Principles. Instead, it switched its larger public companies to International Financial Reporting Standards (IFRS). Then, following a policy of “one size does not fit all,” it wrote its own simplified standards for less complex organizations.

Full Article

Canada is used to being in the middle, caught between its gigantic southern neighbor and the European countries with which it shares many values. Its choice of accounting rules proved no different.

In 2011, Canada abandoned its own Generally Accepted Accounting Principles (GAAP) for its publicly traded companies, saying they had to switch to International Financial Reporting Standards (IFRS). Canada then refined its own national accounting standards to apply only to private companies and other entities, such as nonprofits, that didn't have public investors. “When we were doing this, we said that for a [stock] market that is roughly 3 to 3½ percent of the global capital markets, it doesn't make sense to have our own homegrown GAAP. We should put our global enterprises in a position to use a widely recognized set of standards,” says Linda Mezon, the chair of Canada's Accounting Standards Board (AcSB). Mezon has been a member of the AcSB since 2004, serving during the multiyear IFRS adoption process.

Linda Mezon: “When we were doing this, we said that for a [stock] market that is roughly 3 to 3½ percent of the global capital markets, it doesn't make sense to have our own homegrown GAAP.”

Canada has about 4,000 companies whose shares trade on the Toronto Stock Exchange or the smaller, Vancouver-based Venture Exchange. About 300 of them—worth some 60 percent of the total value of the Canadian market—also list in the United States, Mezon says. When the U.S. Securities and Exchange Commission (SEC) removed the requirement that a company using IFRS had to “reconcile” its results for U.S. investors to U.S. GAAP, “that took a burden off those entities,” Mezon says.

For the remaining 3,700 companies, Mezon says, “U.S. GAAP was too hard for them. They just didn't have the resources to go through all of the literature and all of the interpretations to actually interpret U.S. GAAP. So we made a decision as a board that IFRS was a better choice.”

A number of Canadian companies, however, listed in the United States, pre-IFRS, and have maintained their use of U.S. GAAP. Among them are the two major Canadian railways, several multinational energy companies and BlackBerry Ltd., maker of the once-popular smartphones. Companies representing roughly 20 percent of the combined market value of the 233-company S&P/TSX Composite Index use U.S. GAAP, according to the database S&P Capital IQ. [1]

“They say Canada has mandated IFRS adoption. Well, there is a large number of very important companies that don't follow IFRS but, by choice given the particular exemption that's been allowed, follow U.S. GAAP,” says Stephen Zeff of Rice University, who cites Canada as an example of how “we don't know precisely what countries mean when they say they have adopted” IFRS.

Mezon says countries that required all companies, regardless of size or type, to follow IFRS made a mistake. “It's not appropriate for not-for-profits,” she says; Canada, instead, decided, “We are going to set our own standards for both for-profit enterprise and also not-for-profits.”

The AcSB then created separate standards for each type of enterprise. The board's mantra, Mezon says, was “one size does not fit all.”

The AcSB also rewrote Canada's GAAP to reflect the needs of smaller companies, which are less likely to engage in complex transactions.

Mezon cites financial instruments, such as derivatives or hedging contracts, as an example of how the AcSB accommodated smaller companies. The core principle, she says: “We've got to make this a simpler standard for private enterprise. So we simplified disclosure requirements, we simplified hedge accounting requirements. We, in essence, took it and dumbed it down for what we thought were the prevalent practices a private enterprise would follow. … We didn't have any of the more onerous stuff that existed for the big public enterprises or the banks.”

Critics of IFRS complain that many countries are creating “carve-outs” where regulators or standards-setters pick and choose elements of the standards to follow. Canada retains the right to do that, Mezon says. When there's a proposed IFRS standard, the AcSB publishes it for comment. “We ask one question: ‘Is there any reason why the standard isn't appropriate for application in Canada?’ We get feedback, and we put into our handbook. To date we have not deviated from anything the IASB [International Accounting Standards Board] has issued.”

Mezon adds, however, that in 2011 the AcSB granted a delay to Canada's investment and “rate-regulated” utility companies because the IASB was still working on standards for them. When the IASB subsequently issued its standards, Canada required that those companies follow IFRS starting in 2014 and 2015, respectively.

“So we did two deferrals, but we didn't do carve-outs,” Mezon says. “To date, our policy has been we don't change the IFRS, and we require it on the same effective date as the IASB requires it.”

Anthony Scilipoti, president of the Toronto-based Veritas Investment Research Corp., says, “I believe our process was handled well, and the system we have today is somewhat complex, but workable.” Scilipoti, a former member of the Canadian AcSB who now chairs the Canadian Institute of Chartered Accountants' user advisory council, adds, “I think things might have been easier for us had we waited to see where the U.S. was at, instead.”

About the Author

A Denver-based freelance writer, David Milstead is a regular contributor to The Globe and Mail, the national newspaper of Canada. He has individually or jointly won nine national awards from SABEW, the Society of American Business Editors and Writers. He passed the Level I exam in the Chartered Financial Analyst program in 2007. In a previous report for SAGE Business Researcher, he wrote about pensions.

Notes

[1] “TSX Composite accounting standards,” S&P Capital IQ company screening, Oct. 6, 2015.