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Countdown

Deloitte Canada's IFRS transition newsletter

Welcome to the September 2009 edition of Countdown! We hope you all had a restful summer, and are now back to full strength, with IFRSs coming to the front burner for most publicly-accountable enterprises (PAEs).

The theme of our lead article in this month's "back to school" edition of Countdown marks the progress that has been made in Canada as it relates to IFRS transition. Entitled "IFRS Transition – Where are we now?", Clair Grindley and Delna Madon provide their insights on the choices being made, and trends we are seeing in Canada, based on the results of the Deloitte IFRS transition survey.

In our Lightyear article, the implementation team raises a number of questions this month regarding the first interim financial statements and have approached their Deloitte advisor for advice on "How much is enough? " when it comes to disclosure in the first published financials that they will file under IFRS.

As always, we want to continue to understand and meet your needs, so please submit ideas regarding matters that you would like to see us to address in Countdown to deloitteifrs@deloitte.ca.

See you in October!

Don Newell
National Leader - IFRS services

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IFRS Transition – Where are we now?

By Clair Grindley & Delna Madon


Clair Grindley and Delna Madon are part of Deloitte Canada's National office with a focus on IFRS technical interpretations and implementation issues.

In a few months time, Countdown will celebrate its second anniversary, representing two years of reporting on IFRS transition issues in Canada. Over this time period, the focus of the articles has changed significantly, as our readers' knowledge and needs have evolved.

Back in 2008, articles such as IFRS readiness were a common topic of interest whereas now the interest level is more focused on practical implementation issues and the status and implications of the ever-evolving International Accounting Standards Board (IASB) project plan.

One of the questions we regularly receive from clients relates to benchmarking and obtaining insights into decisions being made elsewhere – be it by entities that have already adopted IFRSs outside of Canada or by other Canadian entities in the process of transition. Certainly, there is some comfort to be obtained from the knowledge that the decisions you are making and judgments you are applying are in line with those of your peers in a new accounting regime where the application of core principles and exercise of sound judgment are prevalent themes.

Given that, for many, the date of transition is only a few months away, now seems a perfect time to make some observations about the current status of IFRS transition in Canada. These observations are based primarily on the results of our ongoing Deloitte IFRS transition survey, combined with experience and insights from our Deloitte professionals across the country.

The Deloitte survey compiles the responses of 66 Canadian companies adopting IFRSs in Canada, across all industries and of various sizes (40% of the companies participating in the survey have annual revenues in excess of $1bn). The industry profile of the participants is as follows:

• Financial services	10%
• Consumer business	9%
• Energy (Power, mining, oil and gas)	34%
• Manufacturing	10%
• Public Sector	6%
• Real Estate	4%
• Telecommunications and Technology	10%
• Other	17%

IFRS 1 Exemptions

Business combinations

Despite the ever-growing list of exemptions available under IFRS 1 *First-time Adoption of IFRSs* (IFRS 1), there are some tried and tested old favorites which have proven to be popular with prior adopters and which are expected to be applied by Canadian companies upon transition. Over 80% of our survey population is planning to take the business combinations exemption, with many PAEs having decided that the ability to reconstruct past acquisitions and any related net benefits from such reconstruction are somewhat limited. We expect this proportion to increase further still with the passage of time.

Employee benefits

The employee benefits exemption is another popular choice with 80% of Canadian companies with defined benefits plans, opting for this exemption. This is perhaps not surprising given the related reconstruction effort as well as the potential elimination of the "corridor" method under IAS 19 *Employee Benefits* (IAS 19).

For those companies with defined benefit plans, this is one of the hardest hitters in terms of opening balance sheet impact: with many Canadian plans in a deficit position, actuarial losses formerly subject to off-balance sheet treatment will be required to be recognized upon transition with an immediate equity charge associated with the corresponding liability recognition. A review of the impact of first-time adoption in the UK showed that, based on published surveys of public companies, the adoption of IAS 19 caused, on its own, the biggest reduction in equity (on average between 20% and 30%), due to the exercise of the IFRS 1 exemption, the existence of significant plan deficits and/or the policy choice to eliminate the use of the corridor method to defer recognition of actuarial gains and losses.

Fair value as deemed cost

Regarding the use of the fair value as deemed cost exemption; our survey is currently showing a 50/50 split for the election of this exemption. Remember that this an exemption where a first-time adopter has the ability to selectively apply this to its long-lived asset basis in contrast to many other exemptions which must be applied unilaterally to all like transactions and account balances. Some of the key reasons for selecting this exemption are noted below:

- Time/effort/ability to implement IAS 16 – *Property, Plant and Equipment* (IAS 16) on a retrospective basis;
- Strategic reasons related to presentation of financial position and performance;
- Prior "qualifying" transaction which used event-driven fair value measurements under Canadian generally accepted accounting principles (GAAP); and/or
- Facilitates, or is required by, ongoing IFRS policy choice (e.g. revaluation model).

Other exemptions

Regarding the planned use of the other elective exemptions, popular selections include cumulative translation differences (73%), decommissioning liabilities (57%), leases (42%) and borrowing costs (50%).

IAS 16 – *Property, Plant and Equipment* (IAS 16)

Some of the transition issues that have regularly been healthily debated relate to IAS 16. This contains an additional layer of rigour relative to Canadian GAAP on matters such as the establishment and review of useful lives relating to assets and significant parts of assets (components) for depreciation purposes.

Regarding the significant parts requirement, no definition is provided within IAS 16 as to what constitutes "significant", but our survey results indicate that enterprises are making their own assessments of "significant" based on consideration of monetary thresholds and/or percentage of the total cost of the asset. Such decisions are being made in connection with consideration of capitalization thresholds (established for practicality purposes) within the entity. The range of what constitutes "significant" in practice is fairly broad, with the key being to establish a basis that is workable for the entity and then applying this on a consistent basis.

Unlike Canadian GAAP, IAS 16 allows the use of the revaluation model as a measurement basis but expected use in Canada is currently expected to be in single figure percentages for Canadian adopters. Specifically, this excludes investment property which can be measured at either fair value or cost with the fair value model expected to form the majority choice for real estate companies.

IAS 17 – *Leases* (IAS 17)

IAS 17 contains the same underlying premise as the current Canadian guidance but notably removes the "bright line" tests that have formed the basis for many classifications under Canadian GAAP through "pass" or "fail" type classifications (e.g. whether or not the present value of the minimum lease payments represents 90% or more of the fair value of the leased asset). Under IAS 17, a number of indicators are required to be considered in order to determine the economic substance of the arrangement and support a conclusion as to whether the asset and obligation should be recognized on the balance sheet. Approximately one third of the companies we surveyed had leases which were on the border of a Canadian GAAP percentage threshold but, for the most part, were not anticipating any change in the lease classification. This seems a sensible conclusion given that the spirit of the guidance is the same; however, some classification change was expected in a small proportion of the population surveyed, perhaps due to leases which under Canadian GAAP, fell below a bright line but which, in substance (arguably), transferred the risks and rewards of ownership to the lessee.

As with revenue recognition (see below), leases are an area where fundamental changes are planned down the road. A new standard on leases (planned for issuance in 2011) proposes to eliminate the on/off balance sheet dilemma and instead establish a "right to use" asset for all leasing arrangements, with a greater focus on the measurement of the asset and related liability as opposed to whether or not they should be recognized.

IAS 18 – *Revenue Recognition* (IAS 18)

The majority of companies surveyed did not anticipate any change in revenue recognition practices as a result of IFRS implementation. IAS 18 is significantly less prescriptive than Canadian (and US) guidance meaning that many of the current Canadian practices fall within either the specific words of the guidance or key principles that make up IAS 18. Arguably, in some instances, the principles-based approach in IAS 18 provides more alternatives but it may be difficult, perhaps unwise, to change policies on transition when the existing policy is already compliant with IFRSs. Public companies should consider the wording of Canadian Securities Administrators Staff Notice (CSA SN) 52-320 - Disclosure of Expected Changes in Accounting Policies Relating to Changeover to IFRSs (CSA SN 52-320) which states that the pre-transition Management Discussion and Analysis (MD&A) disclosure of expected differences as a result of transition should include:

> "Any difference due to an expected change in accounting policy even though the issuer's existing policy under Canadian GAAP is permissible under IFRSs"

This may represent an early warning that such changes may be subject to review, especially in view of the identified focus areas for fiscal 2010 identified in CSA SN 51-329 - Continuous Disclosure Review Program Activities for the fiscal year ended March 31, 2009 (CSA SN 51-329) which notes that a topical review area for 2010 will include the pre-transition IFRS disclosures.

On a final note, as with leases, revenue recognition is part of the IASB's project plan, with a new IFRS planned to be issued in 2011. Additional work on revenue recognition will come upon implementation of this guidance (currently expected to be effective after IFRS changeover in Canada).

Functional Currency (IAS 21 – *The Effects of Changes in Foreign Exchange Rates* (IAS 21))

Functional currency is another standard where the heart of the guidance is aligned with Canadian GAAP, but there are some IFRS/Canadian GAAP differences that could result in a change in functional currency in "borderline" Canadian GAAP classifications. Remembering that functional currency is a matter of fact and not a free choice, IAS 21 contains a hierarchy of indicators that are to be considered in making this determination. As stated in the basis for conclusions to IAS 21, the indicators in IAS 21.09 are "primary" indicators, whereas those contained in the two subsequent paragraphs of IAS 21 are considered "secondary" in nature. We would not typically expect changes to be frequent as a result of IAS 21 adoption, and our survey results, which indicate a change in approximately 10% of cases, seem to support the subtle but not insignificant difference in the guidance.

Disclosure

Last, but by no means least, disclosure. Approximately 95% of the survey population believed that IFRS financial statements will be more fulsome in terms of disclosure than financial statements under Canadian GAAP. Of the 95% of survey respondents anticipating increased disclosures, 70% believed the increase would be substantive. This result is in line with the general consensus and experience of former adopters of IFRS that IFRSs compensate for the absence of bright lines and specific rules with more detailed disclosure requirements.

Other Observations

Regarding the implementation costs and management of the conversion process, some noteworthy observations are as follows:

- 77% have engaged external advisors to assist with IFRS implementation; the external advisors are also the external auditors in close to 50% of these cases;
- The number of full time employee equivalents dedicated to IFRS transition is between 1 and 14; the average reported figure was 3 employees.

All in all, some interesting, but perhaps not altogether surprising results, with majority decisions often either in line with prior experience (business combinations, fair value as deemed cost) or influenced by future standard-setting developments and the desire to select a policy choice and starting point that will alleviate retrospective application efforts down the road. Most valuable for our readers is the ability to gain some insights into how their decisions measure up to others embarking on the transition path, combined with the knowledge that diversity and changes in practice can be expected, with judgment and consistent application being more relevant than a bright lines approach.

The Real Deal

First Interim Financial Statements

Much of Lightyear's efforts to date have been focused on dealing with policy changes and choices under IFRSs coupled with decisions regarding first-time adoption exemptions. As noted in our survey results, disclosure is one of the areas that is not to be overlooked, with the majority of financial statement preparers anticipating a disclosure increase in the IFRS regime. The first published financial statements that Lightyear will be required to file will be the interim financial statements for the three months ending March 31, 2011 but the Lightyear team, having undertaken some preliminary research, has some questions about presentation and disclosure in the interim financial statements for 2011. The implementation team has approached their Deloitte IFRS advisor, Hugh Guardian, to help them understand what is required in their first set of interim IFRS financial statements and to provide them some detail on how they should proceed.

What's the Deal?

During their first meeting with Hugh, the implementation team requested information on the following questions:

- What guidance should we be following with respect to interim financial statements?
- What do we need to include in our first set of interim financial statements?
- What have other companies in the European Union (EU) done?
- What have early adopters in Canada done?
- Do you have any resources that may be helpful for our first interim financial statements?

Hugh undertook to provide them with guidance on the above to assist them with their first set of interim financials.

Keeping it Real!

What guidance should we be following with respect to interim financial statements?

As with all PAEs adopting IFRSs, Lightyear needs to follow the guidance of IAS 34 – *Interim Financial Reporting* (IAS 34). The basis for this is found in the reference source noted below and has been the subject of some discussion in Canada. Key points of reference for Lightyear to consider are as follows:

- The Accounting Standards Board (AcSB) March 2009 Exposure Draft (ED), Adopting IFRSs in Canada II: Although still in ED format, the AcSB state that it favours the application of IFRSs to the interim financial statements and that the arguments in favour of this approach outweigh those against it. In short, this means compliance with IAS 34 can be presumed to be required.

- Canadian Securities Administrators Staff Notice (CSA SN) 52-324 – Issues relating to changeover to International Financial Reporting Standards (CSA SN 52-324): This Staff Notice proposes to require domestic issuers to disclose compliance with IAS 34 in their interim financial statements commencing with the first interim financial statements in the financial year beginning on or after January 1, 2011.

What do we need to include in our first set of interim financial statements?

Lightyear will need to refer to the two reference points identified above to address the preparation of IAS 34 compliant financial statements along with, of course, IAS 34 itself! Also, CSA-52 -324 adds an incremental requirement for the first interim financial statements being the inclusion of an opening balance sheet at the date of transition.

IAS 34 sets out the minimum components of an interim report, but does not prevent, restrict or discourage an entity from publishing a complete set of financial statements in its interim financial report. The minimum requirements include the primary financial statements with full comparative data and IFRS 1 includes reconciliation requirements that are directly geared towards interim reporting.

The requirements of IAS 34 itself are generally consistent with Canadian guidelines on interim financial statements with the focus being on "*events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period*" There is no explicit guidance however on what level of focus is appropriate when there has been a change in the basis of all of the accounting policies since the year-end.

The most prudent starting point may be a complete set of IFRS financial statements. As to whether less disclosure will be acceptable in Canada, reference to the interim financials already filed in Canada in connection with first-time adoption may suggest that an alternative degree of disclosure could be acceptable. Given we are not yet at the mandatory changeover date, and to avoid the risk of non-compliance with IAS 34 and the CSA proposals, consultation with auditors and/or advisors is recommended.

What have other companies in the European Union (EU) done?

EU-listed companies were required to apply accounting standards adopted for use in the EU which did not mandate the preparation of interim IFRS compliant financial statements at the time of EU adoption. Accordingly, many of the interim reports at the time of IFRS implementation in the EU were prepared in accordance with local GAAP sufficient to satisfy the regulatory and listing requirements applicable to their jurisdiction.

In 2007, following approval of the transparency directive by the EU, compliance with IAS 34 became a requirement for listed companies. A Deloitte report which focuses on interim financial statements under IAS 34 following this directive can be accessed here.

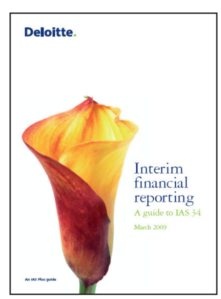
What have early adopters in Canada done?

There are a handful of early adopters that have issued published interim financial statements, with more expected for 2010. The basis of preparation of the financial statements is not subject to either the provisions of the AcSB ED nor the CSA Staff Notice, since these relate to those adopting on the mandatory changeover date only. Rather, the basis of preparation would have been guided by any conditions imposed by the exemptive relief (required for early adoption) granted by the applicable securities commission. A review of published data shows financial statements filed in accordance with IAS 34, disclosure of the IFRS opening balance sheet and disclosure of IFRS compliant accounting policies. In addition, further details are found in the form of reconciliations to prior GAAP (as required by IFRS 1) and full explanatory notes with comparatives for those financial statement line items where the quantum of the adjustment or extent of additional note disclosure (relative to Canadian GAAP requirements for the same line item) is significant.

Do you have any resources that may be helpful for our first interim financial statements?

Deloitte has a number of publications and web-based resources which may be helpful:

1. IAS 34 Interim Financial Reporting prescribes the minimum content for an interim financial report, and the principles for recognition and measurement in financial statements for a financial reporting period shorter than a full financial year. This guide provides an overview of the Standard, application guidance and examples, a model interim financial report, and a compliance checklisst. Click here to download Interim Financial Reporting – A Guide to IAS 34.



2. [Study of Half-yearly Reporting in the United Kingdom](#) (Including IAS 34 Compliance Issues). This Deloitte & Touche (United Kingdom) study found that many companies are failing to comply fully with new reporting requirements for half-yearly financial reports following the UK's introduction of the EU's Transparency Obligations Directive (TOD). Deloitte's report, titled Half a story, considers the impact of the TOD, which introduced more detailed and extensive requirements for half-yearly financial reports, including compliance with IAS 34 and shorter reporting deadlines.

Next Steps: Based on Lightyear's IFRS implementation team's enhanced understanding of the requirements for their first IFRS interim financial statements, they are now ready to move forward with a draft template for their first interim financial statements. An effective dialogue will be established between management, the board and Lightyear's auditors in order to obtain everyone's agreement on the extent and level of disclosure that will best satisfy user needs and ensure IAS 34 compliance in 2011.

Look for next month's issue to learn more about Lightyear's IFRS implementation!

SEC to refocus on IFRS roadmap

The U.S. Securities and Exchange Commission (SEC) Chairman and Chief Accountant have recently stated that they will be refocusing over the next few months on a proposed roadmap to move U.S. companies to IFRS. Based on the 200 comment letters received by the SEC on the released proposed roadmap last fall, it was clear that people agree there should be a single set of global high-quality accounting standards, but there were definite differences in how different groups would like to accomplish this.

Though it was generally felt that the current financial crisis diverted the SEC's attention from the IFRS project, the Chief Accountant noted that it may have underscored the importance of IFRS, nothing that discussions related to the credit crunch, responses and potential solutions were all global in scope.

The SEC has hinted that a handful of large multinationals should be able to convert to IFRS by 2011, even though most companies wouldn't be required to convert until 2016 at the earliest.

Deloitte IFRS publications and events

A comprehensive summary of Deloitte IFRS publications and events is available here.

Please first login, first time visitors will need to complete a short registration form. Below we have included new publications and events most relevant to Canadian companies.

IFRS Publications

Canadian Insurance Industry: A Clear Path to IFRS Conversion. This booklet highlights the accounting considerations and other considerations that are important to the insurance industry in Canada when making the transition to IFRSs in 2011.

Toronto

October 26-27, 2009:

CICA – IFRS Conference for the Rate-regulated Industry in Canada. For more information please click here.

November 17-18, 2009:

INFONEX – IFRS for Real Estate – understanding critical issues affecting financial reporting in the real estate industry. For more information please click here.

International Round-up

Updates and news from the IASB

Don't forget that the comment period for the [Exposure Draft (ED) on Rate-Regulated Activities] ends on November 20, 2009.

August 26, 2009 Exposure draft on improvements to IFRSs

The IASB has invited comment on an exposure draft proposing improvements to eleven different IFRSs. The proposed effective date for most of the amendments is for annual periods beginning on or after January 1, 2011, although entities would be permitted to adopt them earlier. The proposed effective date for the amendments arising from IFRS 3 *Business Combinations* and the consequential amendments to the transition requirements of IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) is July 1, 2010. Comments on the exposure draft are due by November 24, 2009. Click here for further details.

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