Countdown

Deloitte Canada's IFRS transition newsletter

Welcome to the August 2010 issue of Countdown!

With the summer quickly coming to an end, we hope that everyone has taken some well deserved vacation and spent time relaxing with friends and family. Hopefully you are getting well rested and ready for a busy fall ahead!

This month's lead article focuses on enhancing the comparability of International Financial Reporting Standards (IFRS) financial statements. Lightyear is "on vacation" this month and will be back next month tackling new issues in its transition to IFRS.

As you can see from our IFRS Round-up section, there is no shortage of new developments in IFRS this month. We also have some new Deloitte publications and IFRS events planned to help you stay up to date on everything.

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 address in Countdown to deloitteifrs@deloitte.ca.

See you again in September for our 'back to school' edition of Countdown!

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Enhancing the comparability of IFRS Financial Statements

The conversion of Canadian publicly accountable entities (PAEs) to IFRS is driven by the long-run public policy objective of enhancing the global comparability of the financial statements of Canadian entities. But in the short run, there may be a some degree of diversity in the accounting principles used to prepare those financial statements.

IFRS has the following attributes:

- It is principles-based – meaning that judgement is involved in a wide range of such matters as functional and presentation currencies to the components of property, plant and equipment (PP&E) that are depreciated separately;
- It currently permits alternative accounting policies in some areas – for example, joint ventures, non-controlling interests, defined benefit accounting;
- It mandates or permits transition/conversion adjustments that in many cases may carry over matters from predecessor generally accepted accounting principles (GAAP) or eliminate them, depending on the elections chosen or required; and
- The guidance on industry-specific matters, and current lack of specificity in some areas, may result in variations in accounting policies among Canadian and other countries that adopt or have adopted IFRS.

Many differences in accounting policies may arise from the conversion process itself. In the course of conversion, entities may electively decide under IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1) to do any of the following:

- Change the measurement basis of certain financial instruments by re-designating their nature i.e. eligible held for trading financial instruments could be redesignated as held to maturity;
- Change the measurement basis of property, plant and equipment on an item by item basis by employing the "fair value as deemed cost" election;
- Change the measurement basis for investment properties from cost to fair value; or
- Charge previously un-expensed deferred actuarial gains and losses arising from defined benefit pension plans directly to retained earnings.

If different entities elect different combinations of such exemptions, there will naturally be significant variation in the measured opening balances of the assets and liabilities of those converting entities, and likely similar differences will arise in the subsequent measurement of revenues and expenses arising from those items. The International Accounting Standards Board (IASB), when it approved such exemptions in IFRS 1, recognized that this might occur. Nonetheless, the IASB came to the conclusion that the benefits of requiring retrospective application of the relevant standard for each item (instead of permitting the identified election) did not necessarily warrant the costs involved. And in the long run, as such assets and liabilities run off, the comparative properties of all entities reporting under IFRS will be further enhanced – which is the object of the global conversion exercise.

In the meantime, however, some degree of comparability may not exist among the financial statements of Canadian entities, even if they convert at the same date and are in the same industry, to the extent that they elect different combinations of the above items or any other of the elections permitted in IFRS 1 or elsewhere in IFRSs. And these differences are in addition to those differences that may exist arising from permitted alternative accounting treatments of the same items as a matter of continuing IFRS policy, as outlined above.

A challenge, or perhaps an opportunity, exists, therefore, to enhance the comparability of any set of Canadian financial statements prepared in accordance with IFRS with those of other converting Canadian entities or with those of the rest of the world that already report under IFRS.

Comparability: the Search for Common Elements

Comparisons of the financial statements of different entities are rarely carried out on an absolute dollar basis. For example, when comparing the financial statements of two large organizations, it is rare to see analyses that dwell solely on the absolute size of the entities' assets and liabilities, or of their respective revenues and expenses., It is far more common to see comparisons made of scaled ratios of elements of the financial statements – such as net income as a percentage of the common shareholders equity ("return on equity", or "RoE") or of operating income as a percentage of assets ("return on assets" or "RoA").

Similarly, the revenues of entities are frequently compared in terms of their growth rates or in terms of the extent to which revenues are converted into operating income ("operating margins"). Since ratios such as RoE and RoA are nominally comparable across different entities regardless of their absolute size, they are frequently used by analysts and other financial statement users seeking to compare different entities in an industry.

While dividing reported incomes by measured assets produces comparable numbers in terms of scale, comparisons of such ratios are still only valid if (among other things) the measurement basis of the numerators and denominators of the entities being compared are essentially the same. Factors that can invalidate (to some extent) such comparisons can obviously arise as matter of accounting policy or principles as discussed above. They may also include such non-accounting policy factors as:

- Different mixes of businesses when the entity has more than one line of business;
- Differences arising from variations in post-employment benefit plans; and
- Differences arising from the recognition of intangible assets arising from business combinations, as opposed to the expensing of the development cost of similar intangibles for businesses that internally develop similar intangibles but cannot capitalize those costs.

Enhancing comparability

How does one enhance the comparability of financial statements when all these factors are in play?

The following steps may be useful in making enhancements to comparability:

- Understand the accounting policy choices that are used by a majority, or at least a significant subset, of entities in the industry. IFRS is intended to promote international comparability and thus the scope of any survey of accounting policies should include worldwide preparers. To identify such entities, check the stock exchanges (LSE, DAX, Frankfurt, Euronext) of countries employing IFRS for identified members of industries that are the same or similar to yours. In many cases, this will require going to the identified entity's websites as there may be no central filing requirements similar to North American regulatory requirements. And for many countries, be sure to identify the scope of the financial statements being employed, as entities are frequently required to file parent company-only as well as consolidated financial statements. And lastly, be sure to check how current the statements are, and the extent to which the entities have adopted recent changes in accounting standards, of which many have been published recently by the IASB. In many cases, the financial statements of entities in the same industry will look remarkably similar, and accounting policy choices will indicate an industry preference.
- Check what the other Canadian entities in your industry are electing to do. There are several Canadian industry associations that sponsor meetings whereby members can discuss the challenges of converting to IFRSs, and frequently such groups facilitate the exchange of information on elections and policy choices that entities are planning to undertake. Another source of such information is the disclosures required under Canadian Securities Administrators (CSA) Staff Notice 52-320 on disclosure of IFRS conversion progress.
- Do not focus comparisons on the aggregate numbers, particularly in enterprises with diverse business operations. In such circumstances, the comparisons of relevance are likely to be made at the segment level. In addition, looking at disaggregated data takes out the effect of variations in concentrations of entities in specific industries, or

the inclusion of operations that are unique. One might even consider publishing the segmented information on the face of the income statement, a practice of some European entities. This practice highlights the differences between the aggregate performance of the entity and its constituent parts, and enables comparisons to be made with other direct competitors in a segment's field of operations.

- If your entity has had a relatively unique event or transaction that has had a major effect on results, try to highlight that event in the disclosures in the financial statements, if not on the face of the balance sheet or statement of operations. At the same time, recognize that certain words and phrases may not be capable of substantive verification and may not be permitted, under IFRSs, to be employed in financial statements, although they may be in the Management Discussion and Analysis (MD&A). For example, it would be unusual to find in North American practice the identification of an item in the financial statements as "non-recurring." However, an event may be identified by its nature i.e. a disposition, or restructuring, in a narrative or tabular form in the requisite disclosures of reconciling or "roll-forwards" of balances. For example, the effects resulting from the decommissioning of a large factory may be specifically identified in the reconciliations of PP&E required by IFRS. Similarly, the effects of large asset acquisitions, even if they are not business combinations (for which specific information on a pro forma basis may be required) may be specifically broken out as an element of a reconciliation table. This would enhance the ability of readers to understand the comparable results of the preceding or subsequent periods. Consider avoiding the use of descriptions of events in the financial statements as "one-time" or "non-recurring"; it is probably unnecessary in any case, as enlightened followers of an entity will know the nature of the event.
- Recognize that some specific events will have a "step-effect" on the comparative financial statements, and emphasize in the disclosures the effects of such step events. For example, significant business combinations that result in the enhancement of an existing business line will change that business's comparative metrics in the year of the combination – and also affect comparisons in the subsequent year. IFRS 3(R) *Business Combinations* (IFRS 3) requires entities to report, on a pro forma basis, the full-year effects of a combination that was closed at some point during the year. These disclosures may be included in the business combinations note, but they may be the most significant contributor to year-to-year variations in results. Such information may be utilized in other notes and, in fact, many reconciliations of "roll-forwards" explicitly require the recognition of the effects of significant asset acquisitions and dispositions. Utilize those disclosures to provide a coherent picture of the entity's performance. It is likely that any plain, true and full disclosure in other aspects of financial communications – such as the MD&A or press releases will have emphasized some of the effects. One of the attributes of IFRS is that it does in fact require reconciliations of all changes in significant accounts. Such reconciliations and the insights that can be gained from them were not present under previous Canadian GAAP but will be there in the IFRS statements – so make the most of this.
- Treat the financial statements as an element of the entity's communications strategy rather than as an accounting document. Consider providing a narrative description at the head of each disclosure that describes, in words, the significant changes, and then offer the reconciliation. This should enhance the comprehension of the transactions as well as the data.
- Link elements that are related even though not necessarily disclosed together. For example, business combinations that are financed by the issuance of shares or by debt will change the assets, the results of operations and the cash flows (although the impacts on the latter may be minimal if the transaction was done for "paper"). Similarly, discussions of changes in debt levels should refer to the assets acquired in the business combination, as should the discussion of changes in equity.

Some overall conclusions

Comparability in financial statements is vital for investors to draw reasonable conclusions about the relative performance of entities. However, for a variety of reasons – not the least of which may be elections legitimately taken under IFRS 1– an entity's financial statements may not be as comparable to its competitors as preparers or users would prefer in the near term. As previously mentioned, another way to enhance comparability is to consider treating the financial statements not only as an accounting exercise (for which compliance is mandatory) but also an exercise in communicating important elements that in fact affect the year-to-year comparability of financial statement data. This approach – while being careful not to use words and phrases that cannot be substantiated – offers an inexpensive way of enhancing an understanding of the transactions that affect an entity's financial condition. Given the resources committed to IFRS conversion in the first place – mostly in the name of enhancing international comparability – it would seem a worthwhile investment.

Canadian securities update

IFRS transition disclosures

Last month, in addition to the publication of the results of their Continuous Disclosure Review Program, the Canadian Securities Administrators (CSA) issued a notice disclosing the results of their latest review on IFRS Transition Disclosures. This review focuses on issuers' disclosures related to its IFRS transition efforts and shows an improvement in the quality of disclosure by reporting issuers on their upcoming transition to IFRS, as provided in their 2009 annual Management's Discussion & Analysis (MD&A).

This year's disclosure review showed the following findings:

- 95% of issuers reviewed disclosed their IFRS changeover plan, though not all provided an in-depth discussion of all key elements assessed as part of their changeover plan.
- 60% of issuers described milestones and anticipated timelines associated with each of the key elements of their IFRS changeover plan.
- 82% of issuers reviewed identified accounting policy differences between Canadian generally accepted accounting principles (GAAP) and IFRS. This is further discussed below.
- 80% of issuers provided an update of IFRS transition information from disclosures made in their 2008 annual and 2009 interim MD&As.

With respect to the identification of accounting policy differences, the review by the CSA focused on the requirement to disclose "major identified differences between the issuer's current accounting policies and those the issuer is required or expects to apply in preparing IFRS financial statements". In their findings, the CSA noted that while a significant number of issuers reviewed identified such differences, the extent to which the analysis was done varied considerably. For example, some issuers included a listing of new standards to be followed under IFRSs, as opposed to a substantive discussion of those key policies which are expected to change, the reasons for this and the expected impact on the results and financial position of an entity.

Within the CSA's report, a number of pages are focused on core standards or industry-specific matters, which is informative for those in the process of transition both in terms of future disclosures as well as in the context of getting perspectives of other entities' transition activities.

To review the findings in more detail, the report can be accessed in CSA Staff Notice 52-326 *IFRS Transition Disclosure Review*.

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 publicly-accountable enterprises.

Publications

Out of 100: What's your degree of financial literacy?

Executives, board members, and those who prepare financial statements are all expected to have some degree of financial literacy. With publicly accountable entities in the process of migrating from Canadian GAAP to IFRS, maintaining financial literacy is a challenge. To help assess your financial literacy, Deloitte offers this interactive assessment. It will help you evaluate the elements of your financial literacy across four areas: Canadian GAAP, IFRS principles, internal controls and financial statements interpretation.

Click here to access the online version of the assessment. For a printed copy please contact your Deloitte representative.

The IFRS Changeover – A Guide for Canadian Users

The IFRS Changeover – A Guide for Canadian Users is intended to orient users of external financial reports and members of audit committees to matters arising from Canada's imminent change in accounting standards for public companies. Unlike other publications issued by the Canadian Performance Reporting Board (the CPRB) that focus on Management's Discussion & Analysis, this guide is unique in that it focuses on raising awareness in the user community about the potential effect of the changeover on performance metrics and informing users about some of the more common differences that they will encounter. Members of audit committees have also expressed an interest in its non-technical approach, and focus on users' reaction to IFRS-based financial statements.

Click here to access the online version of this publication. For a printed copy please contact your Deloitte representative.

IAS 34 – Interim financial reporting: A Canadian perspective is a comprehensive reference source for financial statement preparers and users with a working knowledge of Canadian GAAP and securities requirements. The guide frames IAS 34 in a Canadian perspective and combines international reporting requirements and timely regulatory information into a single document. The report is relevant to financial statement preparers both before IFRS adoption and throughout the adoption process. It will also be relevant to first-time adopters. The guide also includes sample interim financial statements and a compliance checklist. For more information click here.

Webcasts

IFRS technical update – Keeping Current!

Our quarterly IFRS technical updates provide some highlights relating to both recent developments in IFRSs and perspectives on transition in Canada. Combining technical expertise with practical experience our webcasts discuss what's new and what's next in IFRS and a variety of other matters.

Upcoming webcasts

- **September 8, 2010 (French version)**
  Click here to register
- **September 21, 2010 (English version)**
  Click here to register

Past webcast

- **June 22, 2010 (English version)**
  View archive here

IASB Revenue Recognition Webcast - Looking Ahead!

The Revenue Recognition Exposure Draft (ED) was issued at the end of June 2010. If the ED is finalized as drafted, there will be significant changes in how some transactions are accounted for. Learn about the key differences from current accounting standards and understand how these changes may impact your organization. If there are issues that you believe the standard setters need to reconsider, you will still have time to submit a comment letter (comments are due October 22, 2010).

- **September 27, 2010 (English version)**
  Click here to register

Gatineau, Québec

- September 19-22, 2010

Canadian Insurance Accountants Association (CIAA) – GPS 2010 – CIAA 47th Annual Conference.
For more information please click here.

Toronto

- September 13-14, 2010

CICA – Conference for Audit Committees.
For more information please click here.

- September 21-22, 2010

Acumen – IFRS Update for Financial Institutions – Replacement of IAS 39, IFRS 4, Consolidation.
For more information please click here.

- September 23-24, 2010

Acumen – 2010 OSC/IFRS Update.
For more information please click here.

- September 23-24, 2010

Investment Industry Regulatory Organization of Canada (IIROC) – Financial Administrators Section Annual Conference 2010.
For more information please click here.

Calgary

- September 20, 2010

IASeminars – IFRS Hot Topics for Canadian Oil and Gas Entities.
For more information please click here.

IFRS Round-up

Updates in Canadian and International news

July 29, 2010 – Canada proposes a two-year delay in IFRS implementation for qualifying entities with rate-regulated activities

The AcSB has issued an exposure draft (ED) proposing a two-year delay in IFRS implementation for qualifying entities with rate-regulated activities since "Financial statement preparers in Canada currently recognizing regulatory assets and regulatory liabilities require certainty about how they should account for the effects of the actions of their rate regulator when adopting IFRSs for the first time." The new implementation date would be January 1, 2013, with early application permitted. Comments on this ED are requested by August 31, 2010.

July 30, 2010 – IASB publishes exposure draft for new IFRS – Insurance Contracts

The IASB published an ED of a proposed IFRS for insurance contracts. This ED proposes a single IFRS that all insurers, in all jurisdictions, could apply to all contract types on a consistent basis. The proposed IFRS would apply to writers of both insurance and reinsurance contracts. The deadline for comments on this ED is November 30, 2010.

Deloitte has issued a press release and an IFRS in Focus Newsletter – Insurance Contracts commenting on the issued ED.

August 9, 2010 – Canada proposes a delay in adoption of IFRSs by investment companies

As part of its project on consolidated financial statements, the IASB has announced it will propose that investment companies should be exempted from consolidating and should account for controlling interest in other entities at fair value. Concerns were raised about whether the revised standard, including the investment company exemption, will be issued in time for the mandatory adoption of IFRSs by Canadian PAEs. The AcSB has thus issued an exposure draft proposing that investment companies can continue to apply the current accounting standards for an additional year. Adoption of IFRSs will be mandatory for interim and annual financial statements relating to annual periods beginning on or after January 2, 2012. The AcSB decided that the proposed deferral of the IFRS changeover date should be limited to those entities expected to qualify for the IASB's proposed exemption from consolidation. The comment period for this ED is open until August 23, 2010.

August 17, 2010 – International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) publish proposals to improve the financial reporting of leases

The IASB and FASB published for public comment joint proposals to improve the financial reporting of lease contracts. The proposals are one of the main projects included in the boards' Memorandum of Understanding. The proposals, if adopted, will greatly improve the financial reporting information available to investors about the financial effects of lease contracts. The exposure draft issued in August 2010 is open for comment until December 15, 2010.

Deloitte (Global) has issued a press release on the IASB and FASB proposals to overhaul lease accounting and Deloitte (United States) has published a new Heads Up newsletter – FASB Draws a Bright Light Through Operating Leases discussing the exposure draft.

August 20, 2010 – IASB issues staff draft of IFRS on Fair Value Measurement

The IASB has issued a staff draft of a forthcoming IFRS on fair value measurement, reflecting the tentative decisions made to date by the IASB and the FASB. The IASB is not requesting comments on the staff draft but notes the FASB issued a nearly identical proposed Accounting Standards Update (ASU) *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, which has a comment period deadline of September 7, 2010. The IASB and FASB expect to jointly consider comments received in developing a joint standard, which is expected to be issued early in 2011. Deloitte has also issued the following newsletters related to fair value measurements:

- IFRS in Focus newsletter *IASB issues Exposure Draft on Fair Value Measurement Disclosures*

- Heads Up *Converging on Fair Value – FASB Proposes Guidance on Fair Value Measurement and Disclosure*

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