

International Financial Reporting Standards

Is your tax department IFRS-ready?



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Agenda

- Background
- IAS 12 Exposure Draft Highlights
- IFRS – Impact on Tax Functions
- Canada Revenue Agency Comments / Actions
- Conclusion / Questions

IFRS across the World

More than 100 countries require, permit, or are converging to IFRS.

All major capital markets changing... even the US?



- Countries converging to IFRS with the goal of adoption
- Countries that require or permit IFRS
- Countries pursuing convergence with IFRS, but with no plan to adopt

Top 10 Global Capital Markets	
US	US GAAP
Japan	Converging to IFRS
UK	IFRS
France	IFRS
Canada	Converging to IFRS
Germany	IFRS
Hong Kong	IFRS
Spain	IFRS
Switzerland	IFRS or US GAAP
Australia	IFRS

Background

- IFRS – International Financial Reporting Standards
- Standard setter – International Accounting Standards Board (IASB) founded in 2001 and based in London
- International Accounting Standards Committee Foundation
 - Exercise oversight
 - Raise funds
 - Appoint IASB members
 - Similar to Financial Accounting Foundation (FAF)
- Predecessor organization was International Accounting Standards Committee, founded in 1973

Principles – based

- IFRS, Canadian & U.S. GAAP built under principles-based methodology
- However, US GAAP is more prescriptive and contains rules addressing specific industries and types of transactions in many areas
- 2,500 pages vs. 25,000 pages



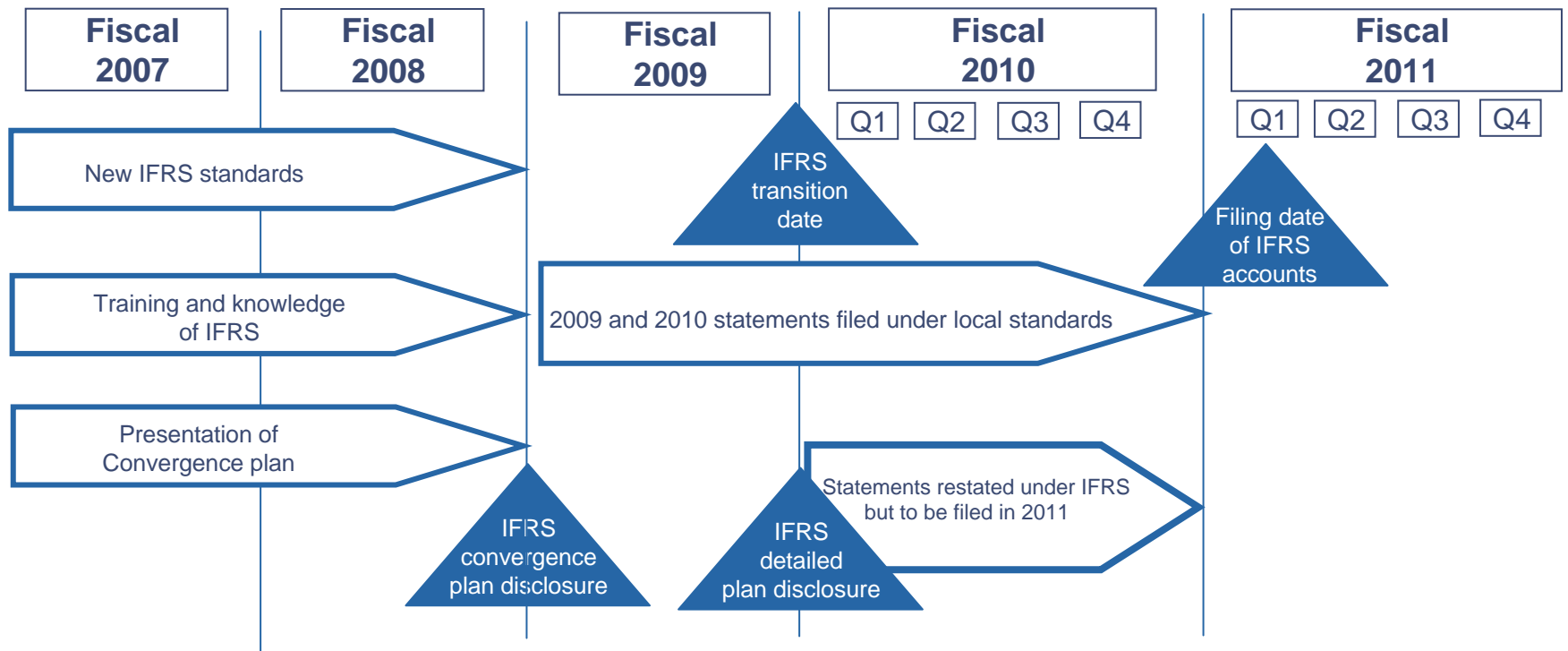
- IFRS:
- Standards
 - IFRS
 - IAS
 - Interpretations
 - IFRIC
 - SIC
 - Framework



- US GAAP:
- Standards:
 - SFAS
 - APB
 - ARB
 - Interpretations
 - FSP
 - EITF
 - FIN
 - Concepts Statements
 - Other
 - FTB
 - AICPA Interpretations
 - SOP
 - AICPA Industry Guides, SABs, DIGs, etc.



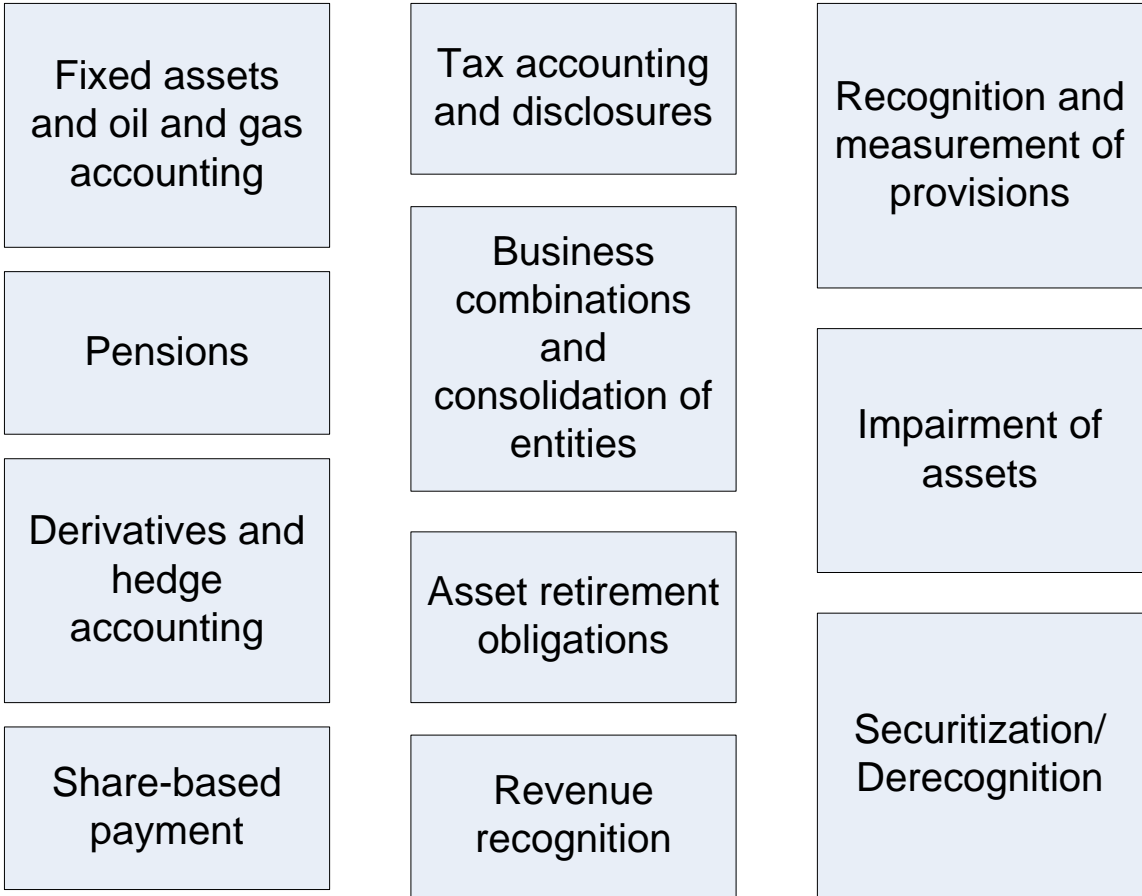
Canada's Transition to IFRS



Application of IFRS to US Companies

- Previous exemption provided for Foreign Private Issuers
- August 27, 2008 SEC voted to publish for public comment Roadmap for use of IFRS
- Decision to be made in 2011 to adopt or not adopt under existing proposal
- Large accelerated filers would adopt IFRS in 2014
- Accelerated filers would adopt IFRS in 2015
- The rest would adopt IFRS in 2016
- **Canadian Exemption for U.S. GAAP filers**

Key Differences Between IFRS and Canadian GAAP



IAS 12 Income Tax Exposure Draft

- Issued in late March 2009
- Written comments must be received by July 31, 2009
- Proposal is to replace IAS 12 Income Taxes
- FASB plans to issue its own “Invitation to Comment”

Steps in Accounting for Income Tax

- a) Record current tax including effects of tax authority review
- b) Identify assets and liabilities expected to affect taxable profit if recovered or settled for present carrying amounts
- c) Determine tax basis of assets and liabilities – assume sale of assets for their carrying amount
- d) Compute temporary differences, unused tax losses and unused tax credits
- e) Recognize deferred tax assets and liabilities
- f) Measure deferred tax assets and liabilities using tax rates that are substantively enacted and that are expected to apply when deferred tax asset is realized or deferred tax liability is settled
- g) Recognize a valuation allowance against deferred tax assets so that net amount equals highest amount that is more likely than not to be realizable against taxable profit
- h) Allocate current and deferred tax to income and equity and classify assets as current or non-current
- i) Disclose the required information

Don't Book Deferred Taxes

- Paragraph 10
 - No taxable income on settlement of carrying amount
 - Equal taxable income and deductible amounts
 - Nil tax rate

Enacted or Substantively Enacted Tax Rates

- Exposure Draft – Paragraph 14
- “Substantively enacted” occurs when any future steps in the enactment process will not change the outcome
 - For U.S. tax jurisdictions point of substantive enactment is when legislation is enacted

IASB Exposure Draft – Key Differences vs S.3465

- Tax Basis
- Uncertain Tax Positions
- Business Combinations
- Initial Recognition on Asset Acquisition
- Inter-company Transactions
- Foreign non-monetary Assets and Liabilities
- Tax Credits
- Disclosures

Tax Basis

- Equals amount deductible if asset recovered through a sale
- If recovery of assets through sale creates no taxable income, tax basis deemed equal to carrying amount
- IASB understood tax basis could be different based on use but said alternatives too difficult to implement
- But also concludes that tax rate should be based on expected manner of recovery

Recognition of Deferred Tax Assets and Valuation Allowances

- IAS 12 – only recognize deferred tax asset when it is probable that it will realized
- Exposure Draft
 - Recognize/compute all deferral tax assets
 - Recognize valuation allowance so net amount equals highest amount that is more likely than not to be realizable against taxable profit
 - Essentially U.S. GAAP model

Uncertain Tax Positions

- Paragraph 26 Exposure Draft
- Requires use of probability-weighted average amount of all possible outcomes
- IASB rejected the concept of a cumulative probability-based recognition threshold
- IASB recognized that this approach need not be applied to possible outcomes that might be **remote**

Business Combinations

- Unrealized assets of “purchaser” and target recognized through business combination
- Prior to adoption of S.1582, subsequent recognition applied to adjust goodwill, the unamortized assets, then income tax expense
- After adoption of S.1582, recognition to earnings

IAS 12 Exposure Draft

- Purchaser assets separate from consideration in purchase equation
- Recognition of DTA’s “outside of measurement period” through earnings

Initial Recognition of Deferred Tax Liability on Asset Acquisition

- IAS 12 prohibits recognition of deferred tax assets or liabilities on asset acquisition that is not a business combination
- Exposure Draft
 - Rejected U.S GAAP iterative calculation approach
 - Rejected initial proposal to calculate tax based on fair market value
 - Calculate future tax as cost – tax base x tax rate
 - Difference between purchase price and sum/net of cost and future tax recognized as purchase discount allowance on deferred tax
 - Difference recognized in profit or loss as the related deferred tax asset or liability is realized

Exposure Draft Example

- Cost 1,950
- Tax basis 1,728
- Tax rate 30%

Entry

Dr Asset	1,950
Dr Deferred tax liability discount	67
Cr Deferred tax liability	67
(1,950-1,728) x 30%	
Cr Cash	1,950

Intercompany Transfers of Assets

- Handbook 3465 and FAS 109 prohibit recognition of future tax asset and defer actual taxes paid
- IAS 12 had no such exception
- Exposure Draft – no specific section other than in disclosures
- Paragraph 48(d) – disclose
 - (i) deferred tax assets and liabilities from intercompany transfers
 - (ii) net affect of transfers on tax expense
 - (iii) subsequent changes including reversals of transfers

Intragroup Transfer of Assets

Vendor

Net book value and tax cost	600
Sales proceeds	1,000
Tax rate	30%

Purchaser

Tax cost	1,000
Book cost = vendor's NBV	600 (After elimination of profit on consol)
Tax rate	40%

Purchaser – deferred tax asset 160

Vendor – current tax expense 120

Consolidated tax gain 40

BC48 indicates Group entity has made a tax gain that should be recognized

Investment in Subsidiaries and Joint Ventures

- Paragraph 21 and B5 in Application Guidance
- Do not recognize deferred tax asset or liability for temporary difference between carrying amount and tax basis in an investment in a foreign subsidiary or joint venture if:
 - the investment is essentially permanent in duration and
 - it is apparent that temporary difference will not reverse in foreseeable future
- Exception doesn't apply to domestic subsidiaries or joint ventures
- Canadian Tax Law: address tax free distributions

Tax Effects of Distributions

- B31 – Some jurisdictions tax rate or tax payable is affected by retention or distribution of profit or retained earnings
- Measurement of current and deferred taxes and liabilities shall include the effect of the entity's expectations of future distributions
- Consider past experience, retention, ability to make distributions, etc.

Foreign Nonmonetary Assets and Liabilities

- Handbook 3465 and FAS 109 prohibit recognition of deferred tax asset or liability related to nonmonetary assets translated at historical rates
 - IAS 12 contains no such exception
 - Exposure Draft – Basis for conclusion Paragraphs 50 and 51
- No change to IAS 12 is proposed

Foreign Non-Monetary Assets

Canadian company (C1) owns foreign subsidiary (S1)

Yr 1 – S1 acquires plant for FC 1,000,000

Yr 1 – FC 1,000,000 = \$1,000,000

Yr 2 – \$1 = FC 1.5

Consolidated book cost \$1,000,000

Tax basis still FC 1,000,000

But need FC 1,500,000 to recover \$1,000,000

So new temporary difference FC 1,500,000 – FC 1,000,000 = FC 500,000

Deferred tax should be booked on this temporary difference.

Tax Credit and Investment Tax Credit

- Tax credit – a tax benefit that takes the form of an amount that reduces income taxes payable
- Investment tax credit – a tax credit that is directly related to the acquisition of depreciable assets
- BC 24 – “Beyond scope of this project to include a comprehensive reconsideration of the accounting for tax credits and deductions”

Disclosure – Analysis of Income Tax Expense

- a) Current tax expense on taxable profit in current year
- b) Adjustments of current tax for prior periods
- c) Deferred tax relating to origination and reversal of temporary differences
- d) Deferred tax expenses related to changes in tax rates
- e) Deferred tax effects of change in possible outcomes on review by tax authorities
- f) Adjustments to deferred tax from change in tax status or shareholders
- g) Change in valuation allowance
- h) Tax expense related to change in accounting policies and errors

Effective Tax Rate Disclosure

- Disclose relationship between tax expense and pre-tax profit in either or both of:
 - Numerical recognition of tax expense and accounting profit multiplied by applicable tax rates or
 - Reconciliation of average effective tax rate and applicable tax rate
- Applicable tax rate: rate of tax in the country which entity is domiciled
- Disclose and changes in applicable tax rate
 - How rate was computed

Deferred Tax Assets and Liabilities Disclosure

- For each type of temporary difference, unused losses and tax credits a continuity schedule containing:
 - Amount for each period presented
 - Changes in deferred tax assets and liabilities (with detail)
 - See paragraph 41 (c) - (f) and 45 of ED
 - Expiry date of temporary differences, unused tax losses and tax credits
- Amount and change in valuation allowance

Deferred Tax Assets and Liabilities Disclosure cont'd

- Separately report
 - current and non-current deferred tax assets
 - current and non-current deferred tax liabilities
- Based on financial statement classification of related asset or liability
- If not related to an asset or liability on the basis of when temporary difference is expected to reverse

Other Disclosures

- Estimates of tax relating to future distributions
- Tax expenses related to discontinued operations
- Amount of temporary differences for subsidiaries and joint ventures for which deferred tax liabilities not recognized
- Tax amounts related to intragroup transfers of assets and liabilities

Other Disclosures

- Tax amounts related to computation of tax if entity part of a consolidated group
- Accounting policies for exchange differences on foreign tax assets and liabilities and classification of tax interest and penalties
- If entity not taxed but owners are – that fact and aggregate temporary differences
- Information about major sources of estimation uncertainties (e.g. unresolved tax disputes) including
 - Description of uncertainty and
 - Indication of possible financial effects and timing of effects

Impact of IFRS on the Tax Function and the Tax Life Cycle



Not All IFRS Conversions Are Created Equal

A good conversion program is tactical:

1. Identifies the tax implications of accounting changes
2. Provides a plan and a structural framework for truly embedding IFRS within all functions, inclusive of the tax function.
3. Integrates the necessary people, processes, systems, data, and controls changes with adequate considerations for quality.
4. Establishes a strategy for communicating the tax implications of IFRS.
5. Addresses the education and training needs throughout the organization.

A truly strategic conversion program:

- Achieves all of the above ...
 - **And** provides strategic value to your business.

Not All IFRS Conversions Are Created Equal



Strategic

- Embeds IFRS end-to-end.
- Looks at the effort as an opportunity to embed other changes in your tax function, processes, etc.

Tactical

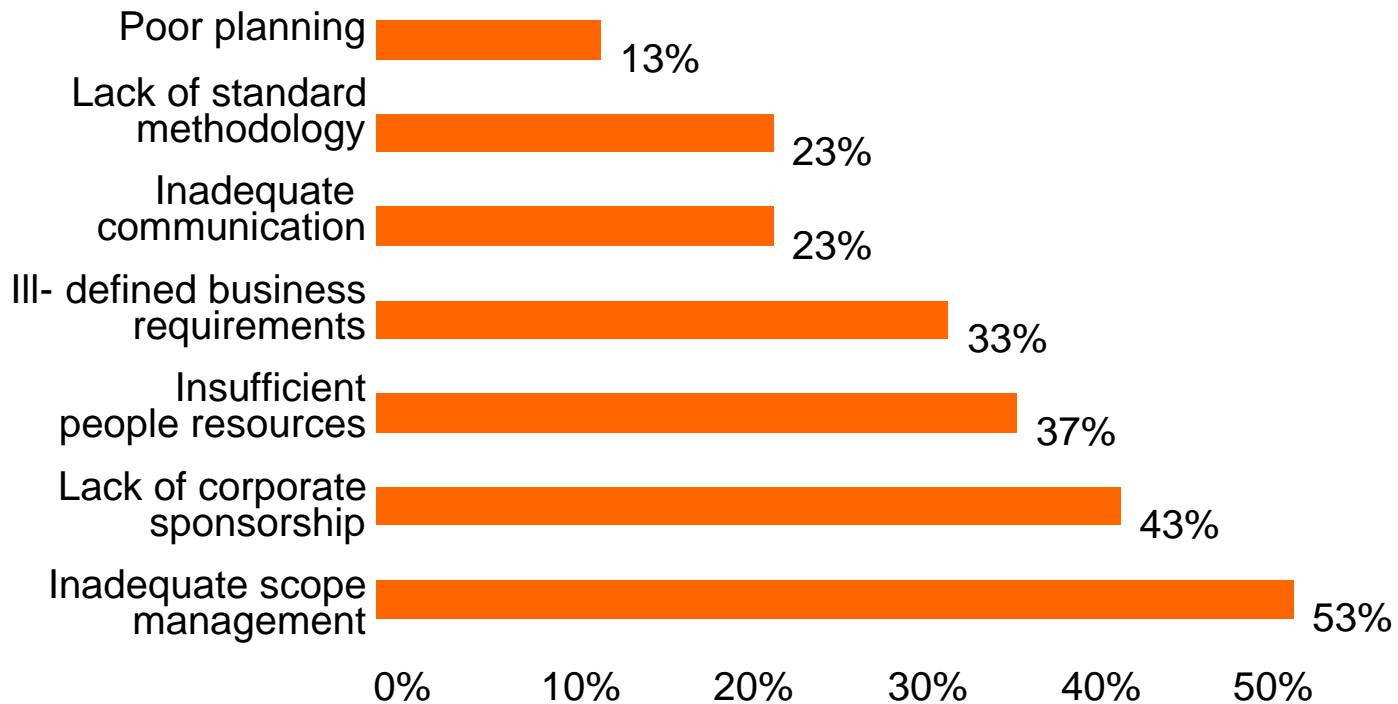
- A robust implementation plan which embeds IFRS into the tax function and throughout the organization.
- Limits its scope to IFRS.

Reactive

- Doesn't embed IFRS end-to-end.
- Focuses on reconciling results with IFRS at the back end.
- Likely results in future fixes post implementation – highly costly.
- Increases risk of error.

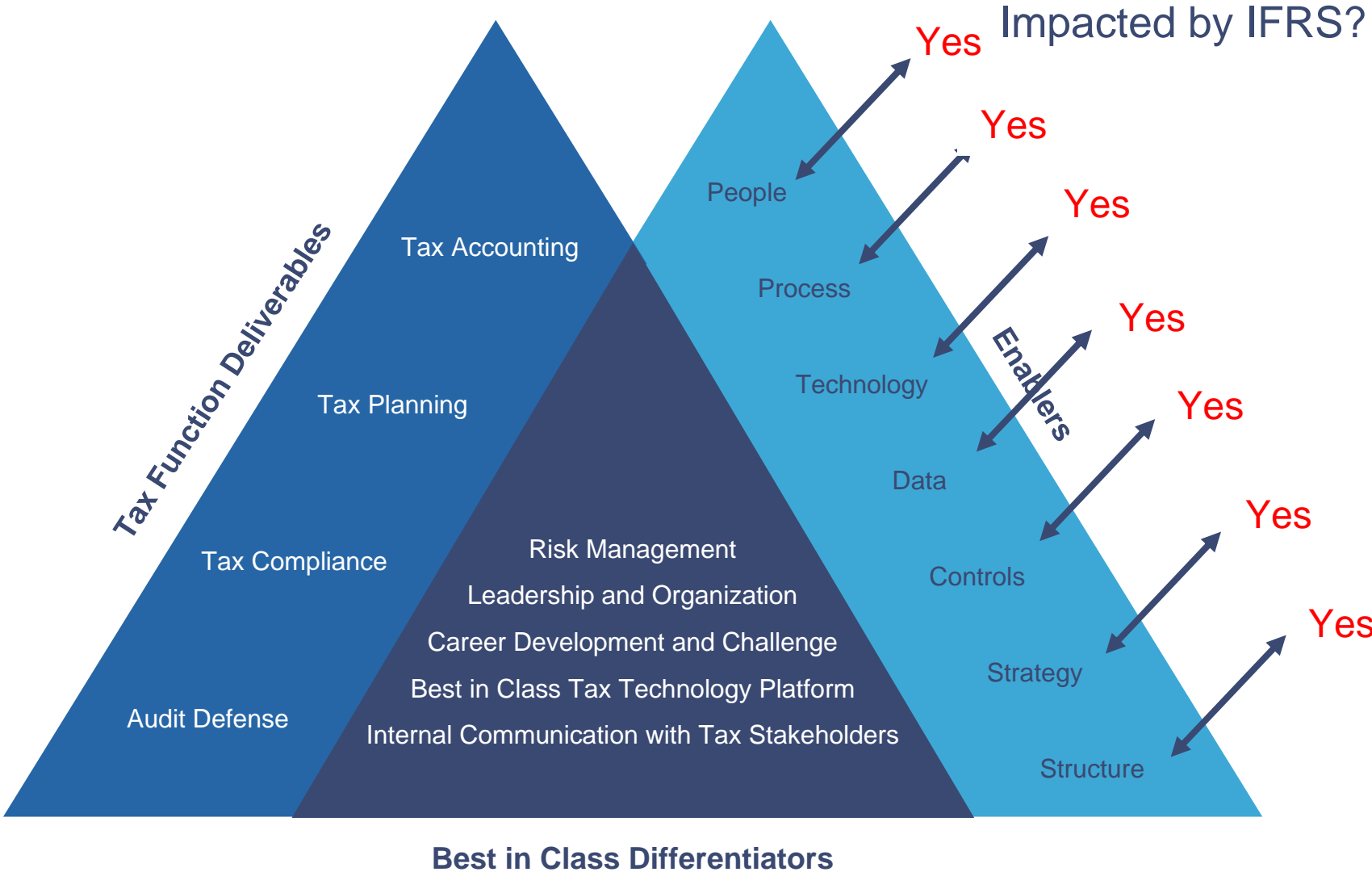
Why Project Management for Tax IFRS?

Why Projects Fail ?



Source: Forrester Group

PwC's Tax Function Effectiveness Framework



People - Communication

Issue:

- Tax & Finance not communicating effectively
- Isolation of tax staff

Opportunity:

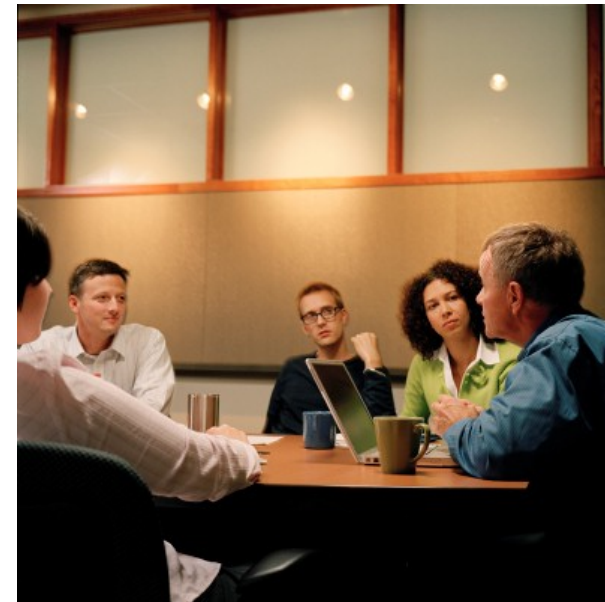
- Improved relations:
 - Involve tax on IFRS task force
 - Joint training

Tax Operations Impact:

- Efficiency Dividend

Key Benefits:

- Improved morale
- Improved communication
- Better alignment of objectives



Internal controls

Issue:

- Process change is inevitable

Opportunity:

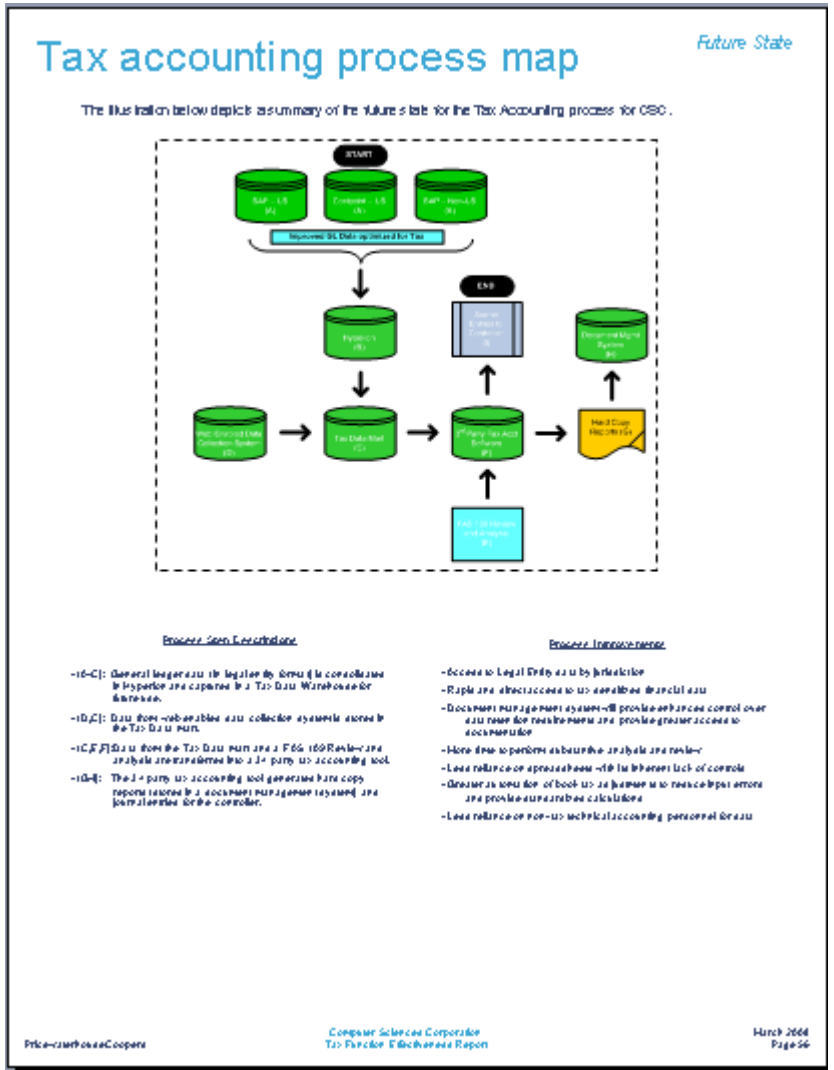
- Improve existing processes & controls
- Address IFRS impact early for all deliverables

Tax Operations Impact:

- Early assessment for:
 - Design and implementation of new controls
 - Proper documentation
 - Appropriate time available for testing
 - Review with independent auditor (if necessary)

Key Benefits:

- No surprises
- Reduce risk of material weaknesses or significant deficiencies
- Faster close cycle



Tax Accounting Technology Implications

Issue:

- Tax technology platform

Opportunity:

- Enhance existing spreadsheets
- Consider 3rd party tax accounting software

Tax Operation Impact:

- Efficiency dividend
- Reliable controls

Key Benefits:

- Improved control environment
- Faster close cycle
- Improved quality of information

Data Disruption

In Theory:

1. Book data required to compute S1 may:
 - No longer be captured or developed
 - Change in format
 - Move to a new or upgraded system
2. New adjustments may result from method changes
3. Historical adjustments may not be applicable going forward

Data Disruption

Issue:

- Obtaining data

Opportunity:

- Automate data collection process
- Team with finance & IT

Tax Operations Impact:

- Efficiency Dividend

Key benefits:

- Improved quality
- Lower risk of errors
- Less overtime
- More tax work and less admin
- Improved job satisfaction

CRA Comments / Actions To date

- CRA has established an IFRS Advisory Committee with 3 key work streams
 - International – e.g. thin cap issues / transfer pricing
 - Domestic – computation of income for tax purposes
 - Other Transitional Issues
- Comments from CRA at 2008 Canadian Tax Foundation

CRA Comments

Question 8-1

- Will the CRA be issuing guidance with respect to taxpayers adopting IFRS in terms of determining taxable income, and in particular dealing with changes from current standards to IFRS?
- Yes. We are currently evaluating these significant changes to accounting principles and their potential impact on the administration of the Income Tax Act
- Forthcoming ITTN

Question 8-2

- Many taxpayers are already required to complete books and records based on IFRS as well as under Canadian GAAP. (For example, Canadian resident subsidiaries of parent companies, where the parent is required to prepare consolidated financial statements using IFRS). Does CRA currently consider IFRS prepared financial statements acceptable to file with a taxpayer's tax return?
- Yes. The ITA does not specify that financial statements must be prepared following any particular type of accounting principle or standard
- It is our view that financial statements based on IFRS would be an acceptable starting point to determine income for tax purposes

CRA Comments Cont'd

Question 8-3

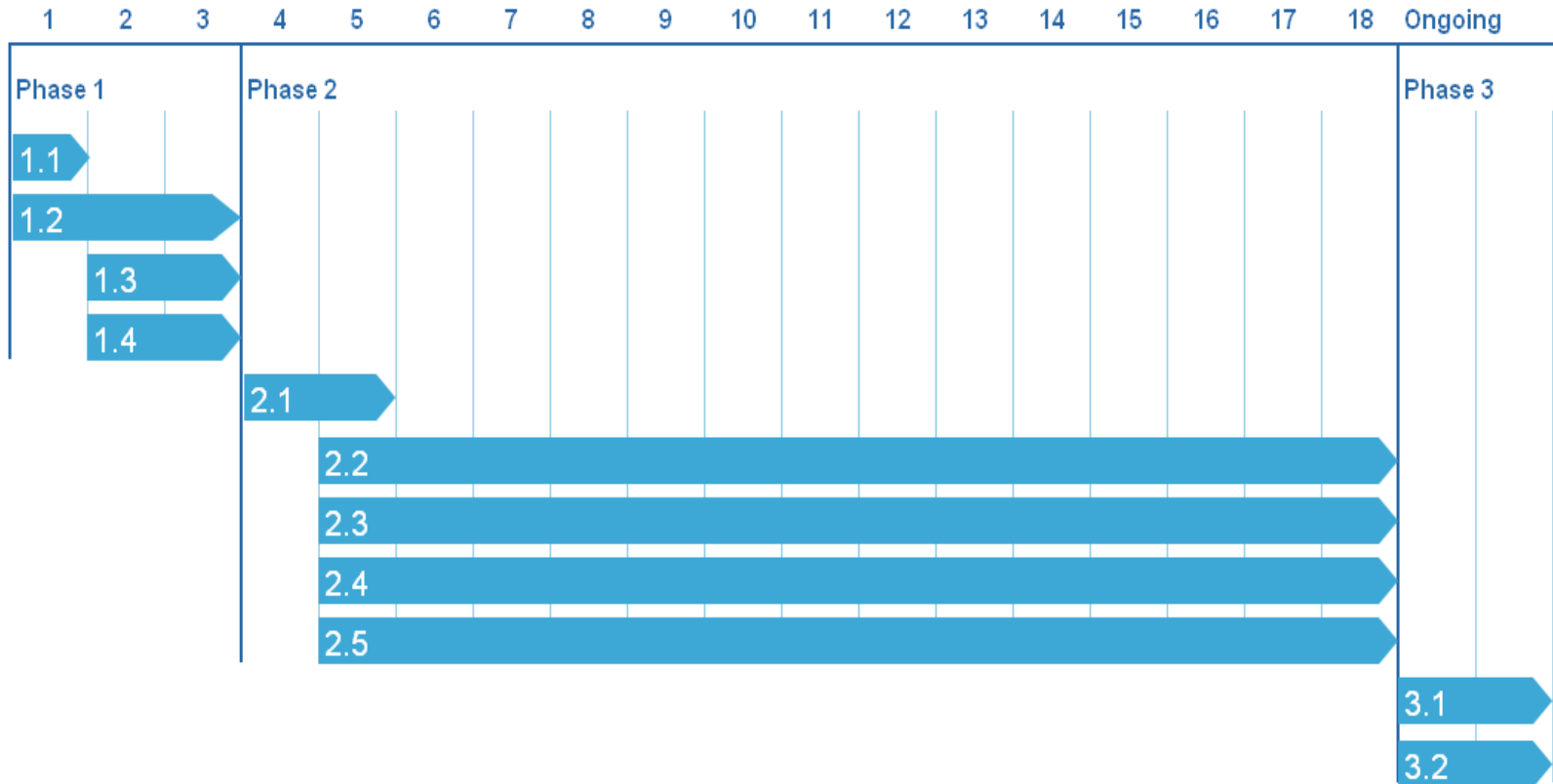
- Is the CRA considering implementing a process through which taxpayers may proactively raise issues expected to be encountered in the process of conversion to IFRS, so as to reduce uncertainty to their current and future tax liability position caused by the adoption of IFRS?
- Yes. Shaun Harkin is available to receive specific queries regarding how the interpretation of Canada's income tax law is affected by any particular IFRS or International Accounting Standard
shaun.harkin2@cra-arc.gc.ca
613-957-9229

Question 8-4

- Established IFRS Advisory Committee
- Will the CRA be working with the provinces to develop a harmonized approach in assessing taxable income in respect of adopters of IFRS?
- We have identified the provinces as key stakeholders in the transition process to IFRS. Accordingly, our Communication Plan will include the provinces to ensure all issues are identified and resolved.

IFRS Tax Action Plan

Months



Phase 1 – Preliminary impact assessment

Phase 2 – Initial conversion to IFRS

Phase 3 – Integration of IFRS

Questions?

Thank You!

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