

Crossing over to IFRS

Questions you should be addressing today



The 2011 date for mandatory adoption of International Financial Reporting Standards (“IFRS”) in Canada is in sight and entities now are focusing on preparing first-time IFRS financial statements, including the balance sheet that converts the entity’s Canadian GAAP financial statements over to IFRS (“the transition balance sheet”). In this memorandum, we discuss questions that have frequently arisen about the preparation, presentation and disclosure of this transition balance sheet, and other related issues. For convenience, the memorandum assumes an entity with a calendar year-end will begin reporting under IFRS in 2011 and provide comparatives only for 2010, so that the date of the transition balance sheet is January 1, 2010.

Consider the questions with care. 2011 is closer than it might seem and, as we discuss further below, some decisions will need to be made and documented by January 1, 2010 if desired accounting outcomes are to be achieved.

Timing and Preparation

1. Does an entity have to prepare the transition balance sheet at the same time it prepares its Canadian GAAP December 31, 2009 balance sheet?

No. Subject to our comments below, it would be possible to defer the preparation of the transition balance sheet until as late as 2011, when first-time IFRS reporting becomes mandatory. However, waiting until then often will impair efficiency and increase the risk of significant error. It also would mean that the

full financial statement impact of converting to IFRS will not become apparent until shortly before IFRS reporting is required. This would significantly limit management’s ability to take remedial action (e.g. renegotiating debt covenants and other contracts, consider the implications of changes in key financial statement ratios, etc.) and communicate on a timely basis the impact to the stakeholders. Prudent practice would be to prepare a draft transition balance sheet concurrent with, or as soon as possible after, the preparation of the Canadian GAAP December 31, 2009 annual financial statements.

Changes to IFRS and Accounting Policies

2. Should an entity prepare the transition balance sheet at January 1, 2010 using the IFRS that are effective on that date? How should these IFRS be applied?

No. Entities must use the same accounting to prepare the January 1, 2010 balance sheet that will apply to the preparation of their December 31, 2011 financial statements. Therefore, such entities need to evaluate which IFRS will be effective at December 31, 2011. These IFRS should be applied retrospectively (except for some aspects of selected IFRS for which IFRS 1, First-time Adoption of International Financial Reporting Standards, (“IFRS 1”) provides exemptions or exceptions). Accounting policies need to be consistently applied for both 2010 and 2011 and interim periods within these years, even if the respective standards would only be mandatorily adoptable by existing IFRS preparers in 2011. The same considerations apply if an entity decides to early adopt accounting standards with effective dates past 2011, as long as the standard permits early adoption.

2011 is closer than it might seem and some decisions will need to be made and documented by January 1, 2010 if desired accounting outcomes are to be achieved.

3. If a change to IFRS occurs after an entity has issued its first interim IFRS financial statements and the change is effective for the entity's December 31, 2011 annual financial statements, does the entity have to restate the transition balance sheet to give effect to the change?

Yes. It will be necessary to restate the transition balance sheet for any such changes to IFRS, unless a change permits or requires prospective application for first-time IFRS reporting. While some accounting standards allow for prospective application by entities already using IFRS, in their transitional provision the IASB decided that, in general, those adopting IFRS for the first time should use the current version of IFRS throughout the periods presented in its first annual IFRS financial statements (that is, retrospective application unless the first-time adopter provisions in the standard or IFRS 1 requires otherwise.)

4. How likely are changes in IFRS between now and 2011?

The likelihood of IFRS changing between now and 2011 is high – the work plan of the International Accounting Standards Board calls for changes to over 20 standards within this time frame, including financial instruments, impairment, fair value, hedging, consolidation, derecognition, financial statement presentation, debt versus equity classification, income taxes, joint ventures, liabilities, pensions, leases and revenue recognition. The work plan can be found at <http://www.iasb.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm>. The IASB has announced that it will consider staggering effective dates of the new standards to help entities undertake an orderly transition to any new requirements. The



CICA publication, *Which IFRSs are Expected to Apply For Canadian Changeover in 2011*, gives CICA staff's estimate of their effective dates and is available at <http://www.acsbcanda.org/international-activities/item25917.pdf>. Entities should monitor progress of the IASB work plan and consider its impact on changeover plans.

In some cases, an entity may have the option of implementing a change in IFRS in 2011 or deferring adoption until a subsequent year. While adopting a change in 2011 would eliminate a "double switch" in accounting (i.e. changing over to IFRS based on the existing standard and changing again a short while later), the systems, internal control and business implications of adoption in 2011 will need to be carefully considered.

5. Under IFRS, entities have the discretion to choose certain accounting policies (e.g. the basis of costing inventory). Do we have to lock down our accounting policy choices under IFRS by January 1, 2010?

No, but failing to do this on a timely basis increases the risk that information necessary for the preparation of the 2010 IFRS financial statements will not be captured by accounting systems and subject to appropriate internal controls. Prudent practice would be for management to have selected, and the audit committee to have considered and approved, the entity's IFRS accounting policy choices by the beginning of 2010, or shortly thereafter.

6. If an entity wishes to adopt an accounting policy under IFRS that is different from the policy it applies under existing Canadian GAAP, does the entity have to consider whether the new policy is more relevant and reliable than the old one?

No. IFRS permits a "fresh start" approach to policy determinations.

7. IFRS 1 grants entities optional relief from having to apply certain IFRS retrospectively (e.g. measuring property, plant and equipment at fair value at the transition date rather than reconstructing what their carrying value would have been had IAS 16 always been applied). Do we have to lock down our choices by January 1, 2010?

No, but choices made under IFRS 1 are subject to the same considerations we raised in our response to question 5.

Accounting Estimates

8. Must the estimates we use in preparing the January 1, 2010 transition balance sheet be consistent with the estimates we used in preparing our Canadian GAAP December 31, 2009 annual financial statements?

Yes, unless there is objective evidence that those estimates are in error.

Prudent practice would be to prepare a draft transition balance sheet concurrent with, or as soon as possible after, the preparation of the Canadian GAAP December 31, 2009 annual financial statements.

9. If IFRS requires us to make estimates in preparing the January 1, 2010 transition balance sheet that aren't required under existing Canadian GAAP, do we have to make those estimates by the time we complete our Canadian GAAP December 31, 2009 financial statements?

No, but estimates must reflect conditions that existed at January 1, 2010 to IFRS (e.g. estimates of market prices, interest rates or foreign exchange rates have to reflect market conditions on that date). In some situations, such as impairment assessments, deferring the making of estimates for a significant period after January 1, 2010 can become more difficult because of the requirement to exclude hindsight from estimates. If possible, additional estimates required under IFRS should be made during the preparation of the 2009 annual financial statements, and subject to the same reviews and approvals.

10. How should events occurring after January 1, 2010 affect the January 1, 2010 transition balance sheet?

Entities should consider whether the subsequent event should result in an adjustment to the transition balance sheet. In general, however, subsequent events occurring after the entity has made an estimate in its Canadian GAAP financial statements for the year ending December 31, 2009 should not result in an adjustment (see answer to question 7).

Designating Financial Instruments as Available for Sale or at Fair Value through Profit or Loss

11. IFRS 1 permits an entity to designate financial assets as available for sale and, if certain conditions are met, a financial asset or financial liability at fair value through profit or loss. Is it necessary to have these designations made and documented by January 1, 2010?

Yes.

Hedging Relationships

12. IFRS requires contemporaneous documentation of hedging relationships in order to apply hedge accounting. Is it necessary to have this documentation in place by January 1, 2010 if an entity wishes to apply hedge accounting from the date of transition?

Yes.

13. IFRS requires periodic assessment and documentation of the effectiveness of hedging relationships in order to apply hedge accounting. Is it necessary to have these assessments done and documentation in place by January 1, 2010 if an entity wishes to apply hedge accounting from the date of transition?

Yes.

It would be prudent for management to have selected, and the audit committee to have considered and approved, the entity's IFRS accounting policy choices by the beginning of 2010 or shortly thereafter.

14. In preparing the transition balance sheet, is it appropriate to assume that existing Canadian GAAP requirements for hedge accounting, including those for documentation and effectiveness assessments, are always in compliance with IFRS?

No. For example, IFRS does not permit the use of the so-called "short cut" method for assessing effectiveness of hedging relationships. Existing Canadian GAAP practices should be reviewed against IFRS requirements to identify differences.

15. The method used for measuring effectiveness of a hedging relationship under IFRS may result in a different measure of ineffectiveness than that under Canadian GAAP. How should an entity account for any such differences in qualifying cash flow hedges in the January 1, 2010 transition balance sheet?

As IFRS 1 does not address this issue directly, we believe there is an accounting policy choice to either (a) true up the amount of cumulative ineffectiveness in retained earnings as part of the transition balance sheet; (b) maintain the amounts recorded in equity under Canadian GAAP in the transition balance sheet and recognize ineffectiveness using IFRS compliant method only to the extent that it arises after the transition; or (c) maintain the amounts recorded in equity under Canadian GAAP in the transition balance sheet and true up the amount of cumulative ineffectiveness as a charge/credit to income in the first reporting period subsequent to the transition date.

Disclosure and Presentation

16. Do we have to include the January 1, 2010 transition balance sheet in first-time annual IFRS financial statements and, if so, is it necessary to provide footnotes for the balance sheet?

Yes, to both questions. The need for footnote information for the January 1, 2010 transition balance sheet should be taken into account in implementation planning.

17. The first statements we will be issuing under IFRS are interim financial statements for the three months ended March 31, 2011. Is it necessary to include the January 1, 2010 transition balance sheet in these statements?

IFRS does not require an entity to include the transition balance sheet in the interim financial statements for any period in the year of adoption, but Canadian Securities Administrators ("CSA") have proposed that this be done. The CSA Staff Notice 52-324 is available at http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20090521_52-324_changeover_ifrs.jsp

18. Is it possible to report the January 1, 2010 transition balance sheet in the notes to interim financial statements?

No. We understand that January 1, 2010 amounts must be presented as a separate column on the interim balance sheet.



19. Does an entity have to provide financial statements and note disclosure equivalent to annual financial statements in its first IFRS interim financial statements?

While the matter is not entirely clear, we do not believe that annual type reporting in first time interim financial statements is required. Nevertheless we encourage companies to consider enhancing the level of their financial statement reporting in their first-time interim financial statements. A major factor affecting the level of information to provide will be the nature and extent of differences from the entity's reporting under existing Canadian GAAP.

Designations of financial instruments and documentation for hedging relationships should be in place by January 1, 2010 to obtain certain accounting outcomes.

Disclosing the Progress of Changeover Plans

20. What MD&A disclosures about the IFRS changeover do Canadian securities regulators expect to see in 2009 and 2010 MD&A?

Management needs to provide sufficient and relevant information that enables investors to anticipate the unique impact of the IFRS changeover to the entity. In addition to a discussion of the status of the changeover plan, 2009 annual MD&A should include a qualitative discussion of major identified differences between current accounting policies and those expected to be applied under IFRS. In 2010, such disclosure in interim and annual MD&As should

be supplemented by the discussion of decisions about accounting policy choices and, if available, quantitative information about the impact of IFRS on the key line items in the financial statements. The CSA Staff Notice 52-320 detailing all the requirements is available at http://www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20080509_52-320_fin-rpt-standards.pdf.

21. Is there a requirement under the existing Canadian GAAP to disclose the progress of our implementation of IFRS in 2009 and 2010 financial statements?

No. The Handbook has been revised to make it clear that such disclosures are not required.

Care and forethought in addressing these questions will help you in your communications, disclosure and the preparation of the IFRS transition balance sheet—key milestones in preparing IFRS-compliant financial statements.

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