
Current financial reporting developments for public companies October 2012

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AC Insights



Welcome to AC Insights

AC Insights provides audit committee members with a summary of financial reporting developments for public companies, how those developments might affect your company and things you may want to think about.

In this first edition, we cover several developments that are applicable or are expected to be finalized before December 31, 2012.

For information on any topics, please speak to your PwC engagement team. Our Accounting Advisory Services team would be pleased to discuss with you how they will be able to help your company implement any new IFRS standards.

IFRS developments

The IASB expects to issue a final standard on general hedge accounting in December 2012. This guidance will be included in IFRS 9: Financial Instruments.

The current standards for hedge accounting have detailed rules that make achieving hedge accounting practically impossible or costly, even when the hedge was economically rational. The proposed guidance addresses these concerns by aligning hedge accounting more closely with a company's risk management strategy.

What will change?

Many of the restrictions that prevented some economical hedging strategies from qualifying as accounting hedges will be removed. Your company will be able to designate, subject to certain criteria, risk components of both financial and non-financial items at fair value through other comprehensive income.

The assessment of hedge effectiveness will still be required at inception and on an ongoing basis; however, the rules for assessing effectiveness have been relaxed and the assessment will only be forward-looking.

The mechanics of hedge accounting using fair value, cash flow and net investment hedges remains unchanged. Disclosures about the effects of hedge accounting are now required in one comprehensive note to the financial statements.

When will it apply?

The new standard will be effective for financial years beginning on or after January 1, 2015. Companies are permitted to adopt the standard early provided they apply all of issued provisions of IFRS 9 at the same time. The impact of these other provisions may not be significant and will depend on the nature and extent of your investments.

How will this affect us?

Hedge accounting will continue to be an accounting choice. Designation of hedging relationships along with supporting documentation will still be required.

The changes will mean more of the hedging strategies used by your company for risk management purposes will qualify for hedge

accounting and your financial reporting can be more consistent with your risk management strategies. If your company had abandoned hedge accounting because of the constraints in the current rules, there will now be an opportunity to reconsider the company's accounting policies.

What do we need to do now?

You should carefully consider whether it would be beneficial to adopt the standard early. This requires considering all aspects of IFRS 9 as well as your existing hedging strategies. Your company may want to assess opportunities for applying hedge accounting or changing hedging strategies to reflect the relaxed accounting rules.

Re-sizing the balance sheet for employee benefits

The IASB amendments to IAS 19, Employee Benefits, will be effective for financial years beginning on or after January 1, 2013. These changes were part of a limited scope review to improve the quality and transparency of information about certain employee benefits.

What changed?

The revisions primarily focussed on defined benefit plans. The balance sheet will now reflect the net financial obligation for benefits or asset without any adjustments to defer the effects of actuarial gains and losses and unvested past service costs. The benefit expense will now include a net interest expense or income based on the net liability or asset position of the plan. This net interest expense or income will be computed based on the yield on high quality corporate bonds.

The standard also requires more extensive disclosures about defined benefit plans about the characteristics and risks of the plans, the amounts included in the financial statements and the uncertainties over future cash flows.

The timing of recognition of termination benefits was also changed to align more closely with the criteria required under old Canadian GAAP

How will this affect us?

The revisions to the standard are to be applied retrospectively and could significantly affect your balance sheet, performance metrics and disclosures.

The changes to defined benefit plan accounting will likely increase balance sheet volatility because actuarial gains and losses and past service costs will no longer be amortized. The balance sheet will reflect the fair value of the plan assets and the present value of the defined benefit obligations. The provisions to compute a net interest expense or income will likely increase the net benefit expense as the impact of the expected return on plan assets are now ignored.

The revisions to termination benefits may delay recognition of voluntary termination benefits compared to existing practice under IFRS.

What do we need to do now?

The impact of the changes should be determined early to assess the impact on the balance sheet, key performance ratios, and other measures. This will involve your actuaries. The analysis may also identify opportunities to make changes to your existing defined benefit plans.

The new disclosure requirements may require additional processes to compile additional information required and to assess which disclosures are necessary to meet disclosure objectives.

Subsidiaries & joint ventures may change your balance sheet

A comprehensive package of new standards and amendments to existing standards were issued in 2011 dealing with subsidiaries, joint arrangements, associates and structured entities. These will be applicable for financial years beginning on or after January 1, 2013 and are retroactively applied.

What has changed?

IFRS 10, Consolidated Financial Statements, introduces a single model to assess whether a

parent company controls another entity. A parent continues to consolidate a subsidiary it controls and the consolidation procedures have not changed.

The control model looks at voting, potential voting and contractual rights and other facts and circumstances (i.e., practical ability to control, special relationships, large exposures) to assess whether one of the investors has control. A parent must have the power to direct key activities of the investee, be exposed to variable returns related to the investee and have the ability to use its power to affect those variable returns. The separate rules for special purpose entities have been eliminated; however, the guidance on control reflects factors to consider when special purpose or structured entities are involved.

IFRS 11, Joint Arrangements, addresses the classification and accounting for arrangements that are controlled by two or more parties under a contractual arrangement. The underlying concept of joint control has not changed and is based on the new IFRS 10 guidance. The classification of a joint arrangement determines the applicable accounting and is primarily based on the rights and obligations of the parties to the joint arrangement. There are now two types of joint arrangements: joint operations and joint ventures.

A joint operation gives the parties to the arrangement direct rights to the assets and obligation for the liabilities. A joint operator recognizes in its financial statements its share of assets held jointly, its share of any liabilities incurred jointly and its share of revenues and expenses incurred jointly.

In contrast, a joint venture gives the parties rights to the net assets of the arrangement and the individual venturers do not have direct rights to the assets or obligations for liabilities of the joint venture. Joint ventures are accounted for using the equity method set out in IAS 28, Investments in associates and joint ventures.

How will this affect us?

The changes to the consolidation guidance are not expected to result in widespread change in the consolidation status of most subsidiaries. More in-depth analysis of the consolidation status will be required when there are more complex voting, potential voting or contractual rights or special circumstances, including when the company is not a majority shareholder, but has a dominant position.

For joint arrangements, the changes may be more pronounced for those industries that have traditionally used proportionate consolidation, particularly when the activities are carried out through separate vehicles. Significant judgment is required in determining whether those activities carried out in separate vehicle are joint operations or joint ventures.

A change in status could have a significant impact on the company's financial position and performance metrics by either adding or removing the balances and amounts from

various line items in the balance sheet and the statements of profit and loss and cash flows.

This may change the perception of the size of the company and its activities.

What should we do now?

Your company should evaluate how the requirements of the new standards affect the classification of the interests in the entity.

For subsidiaries, this requires consideration of all rights held by all of the investors involved with an entity including implicit rights of a dominant investor (i.e., defacto power). Entities that been designed for special purposes or structured will require consideration of all of the facts and circumstances considered in their creation.

For joint arrangements, an analysis of whether the company has direct rights to the assets and obligations of the arrangement will be required. These determinations may require significant judgment and any conclusions should be clearly documented.

Canadian Securities Requirements

Non-GAAP and Additional GAAP measures

The CSA has updated their Staff Notice on Non-GAAP measures to reflect the adoption of IFRS. The guidance is largely unchanged from the guidance that had been previously issued.

The CSA also introduced guidance on Additional GAAP measures presented in IFRS financial statements. Additional GAAP measures are line items, headings or subtotals that are optional under IFRS but may be relevant to understanding the financial statements or similar measures included in the notes to the financial statements.

The notice reminds issuers of their responsibility to ensure that information provided is not misleading and that these measures are subject to the CEO/CFO certifications criteria. The notice provides guidance on naming, presentation and disclosure about these additional measures.

For more information, you may want to read the CSA Staff Notice 52-306 (Revised), Non-GAAP Financial Measures and Additional GAAP Measures.

CSA reviews identify some material deficiencies & disclosure enhancements

The CSA conducted full and selective reviews of over 1,200 companies in 2012.

Financial statements

Some of the common deficiencies related to financial statements reported by the CSA were:

- Inappropriate classification of debt as non-current when the company did not have the discretion to defer the settlement of the debt.
- Completeness of disclosures about business combinations.
- Completeness of disclosures about provisions.
- Accounting for flow-through shares.

MD&A

Some of the common deficiencies in MD&A were:

- Discussion of immaterial information without the inclusion of material information.
- Insufficient analysis of why changes in operating results occurred.
- Lack of disclosure about debt defaults or risk of defaults and expected debt fluctuations when issuers are experiencing liquidity issues.
- Insufficient information about the operations of specialized industry or high-tech sector companies.

Other disclosures

The report identified improvements required in scientific and technical information on mineral projects; disclosures of the fair value of options in the summary compensation table for executive compensation; the executive compensation discussion and analysis; and the process for identifying new board nominees.

For more information, you may want to read CSA Staff Notice 521-337, Continuous Disclosure Review Program Activities for the fiscal year ended March 31, 2012.

SEC Developments

Observations on IFRS financial statements

The SEC staff has been monitoring filings that include IFRS financial statements. The staff has identified some common deficiencies including the failure to include a statement of compliance with IFRSs as issued by the IASB. The SEC staff also indicated they expect an unconditional statement of “substantial doubt” in the auditor’s report when a company has a going concern issue.

No decision on IFRS in the US

The SEC staff released its final report on its IFRS work plan to evaluate the implications of adopting IFRS for US public companies. The staff did not include any recommendations as to whether, how or when IFRS should be adopted in the US. Additional analysis is necessary before any SEC decision is made on IFRS.

The staff report indicates the vast majority of participants in the US capital markets do not support adopting IFRS as authoritative guidance in the US; but there is substantial support for looking at ways of incorporating IFRS into US GAAP. Also, IFRSs are generally perceived to be high quality; but there are concerns over lack of guidance in certain areas, inconsistencies in application, and the strength of the interpretative process and regulatory oversight.

Dodd-Frank Act imposes new disclosures

The SEC continues to issue rules required by provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Some of these rules have social objectives.

Payments by resource extraction issuers

Resource extraction issuers will be required to file an annual report reporting payments

made by the issuers and their subsidiaries and controlled entities to governments for the purpose of the commercial development of oil, natural gas or minerals. Payments (taxes, royalties, fees, production entitlements, bonuses and other material benefits) equal to or exceeding \$100,000 are required to be reported. The annual report is required for financial years ending after September 30, 2013.

Conflict minerals reporting

The SEC has approved a rule requiring SEC issuers, domestic and foreign, to disclose their use of conflict minerals (tantalum, tin, tungsten and gold) and whether those minerals originated in the Democratic Republic of the Congo or adjoining countries (the “covered countries”). Companies will be required implement a due diligence process to determine whether any of its conflict minerals are from the covered countries. An annual report is required to disclose the determination of the origins of its conflict mineral, the due diligence process undertaken and the results of the inquiry. Certain aspects of the report are required to be audited. The report will be based on a calendar year with the first report required for 2013.

JOBS Act to facilitate capital raising by start-ups

The Jumpstart Our Business Start-ups Act enacted in April 2012 has created a number of accommodations in US securities laws intended to make it easier for emerging growth companies to complete an equity IPO and comply with SEC reporting requirements. Emerging growth companies are those with annual gross revenue of less than \$1 billion and include Canadian companies.

Among other things, the Act exempts emerging growth companies from the SOX internal control audit requirements and relaxes some of the disclosure rules for initial registration statements.