

Keeping your head above water...

Recent issues in financial reporting*

August 2008



*connectedthinking

PRICEWATERHOUSECOOPERS 

In this Issue

Ay, now the plot thickens very much upon us now – George Viliers, *The Rehearsal*

OK, OK ... We know you know. Canadian publicly accountable enterprises will have to adopt International Financial Reporting Standards (“IFRS”) in a couple of years and other Canadian companies will have their choice as to whether or not to adopt them.

While we understand that you might be getting tired of hearing about transitioning to IFRS, things have been happening in this arena that you’ve just got to know about. And that, friends, is the primary subject of this ***Financial Reporting Release***. Read about the plans of the International Accounting Standards Board (“the IASB”) to issue a significant number of new standards by 2011, just about when you’re supposed to start reporting under IFRS. About the reaction of the Canadian Accounting Standards Board (“the AcSB”), including its decision on whether to defer the deadline for transitioning to IFRS. About new guidance from Canadian securities regulators on what you have to disclose about IFRS in your MDA and what you’ve got to do to adopt IFRS early. About whether you’ll lose the right to prepare financial statements using US GAAP. About steps being taken to address IFRS accounting for extractive and rate-regulated enterprises, including the possibility of those enterprises getting much needed transition relief. About initiatives to develop an alternative to IFRS for Canadian private companies. About whether or not not-for-profit organizations will have to follow IFRS. What can we say? The plot thickens.

For those of you who are really into IFRS, we’ve got even more. The Appendix summarizes the timelines of individual IFRS projects likely to be of particular relevance to Canadian companies and provides our own unique perspectives on what each project is all about and how it might affect your transition.

IFRS isn’t the only thing happening, of course. The use of fair value accounting in the credit crunch and the complexity of GAAP have provoked international debate. We provide our take on these matters, including our position on using fair values when times are tough. Not to mention a review of new interpretations from the CICA Emerging Issues Committee.

It’s all yours. Cheap, at twice the cost.

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The Future of IFRS

I could see that if not actually disgruntled, he was far from being grunted

– P.G. Wodhouse, The Code of the Woosters

We have news. Big news. The IASB and the Financial Accounting Standards Board (“the FASB”) are accelerating the completion dates of a number of heavyweight projects, including revenue recognition, consolidation policy, asset derecognition, financial statement presentation, debt versus equity, pensions, leases and financial statement presentation. This comes on top of the IASB’s existing projects on joint ventures, discontinued operations and income taxes. All are supposed to be out in the next few years with many scheduled for 2011. Our guess is that you’ll have until 2012 to adopt any IFRS that come out in 2010 and 2013 for those out in 2011. For more details on individual projects, have a look at the Appendix.

Why all the rush for a new and improved set of IFRS? Speculation is rife that the IASB and the US have done a deal – the IASB will upgrade IFRS by 2011 and the US will allow domestic companies to use IFRS for public reporting purposes, perhaps by 2013 and maybe earlier. That’s only rumour though. As we go to press, the SEC has yet to release its long-awaited road map for adopting IFRS in the US although our spies say this is imminent. Public consultations are far from over. There may be life in US GAAP yet.

Does the IASB’s project present problems if you’re planning to adopt IFRS in 2011? Do dogs bark? If the new standards aren’t available for use by the time you begin reporting under IFRS, you’ll have to apply the

existing rules on Day One and then switch over to the new ones later. That’s likely – we expect that at least seven significant new standards won’t be ready in time for 2011 first quarter IFRS reporting. Even if a new standard is ready, take care – you may find it’s necessary to defer adoption until you’ve had a chance to consider its impact on your business, accounting systems and internal controls. Not a happy prospect, that, spending time and money assessing and applying standards that will have only a very short shelf life.

Any chance the AcSB will defer the date of mandatory adoption of IFRS in Canada until 2013 or later to ease the problems? None, nada, zilch. The AcSB issued a terse message about this in late July. Roughly translated it says, “Too bad, so sad. Suck it up, 2011 is the date”. More on this later.

Observation. Unhappy with the thought of adopting IFRS standards on Day One that will change on Day Two? Want the IASB to back off? The political reality is that Canada and other countries joining IFRS in 2011 don’t have the muscle to force such a change in the IASB’s timetable. Alas, we are but a small cog in a very large wheel. Still, we knew all this when we decided to join the IFRS club. In our view, the benefits of becoming a member outweigh the temporary disruptions that might arise in the process of joining. Let’s face it – there never will be a good time to change over.

Canadian GAAP until the Transition to IFRS

By God, Mr. Chairman, at this moment I stand astonished at my own moderation! – Lord Clive, reply during parliamentary inquiry

One question we get all the time is whether Canadian GAAP will change significantly in the next few years until the changeover to IFRS happens. The worry, of course, is that everybody has enough on their plates addressing the changeover.

So what's the answer? Well, there's the official answer and there's reality. The official answer is that the AcSB has said that during the transition period it will assess whether to change Canadian GAAP for new IFRS on a case-by-case basis. Ditto for US GAAP affecting Canadian standards already harmonized with US GAAP. The reality is that Canadian GAAP is on ice and has been for a while now. Consider. In the past year or so, the AcSB has:

- Postponed the date of mandatory adoption of the new global standards on business combinations and minority interest until 2011. That's two years later than the US and a year later than under IFRS.
- Ignored new US rules requiring companies to recognize the surplus or deficit position in pension plans on their balance sheet as assets or liabilities, thus creating a mammoth difference between Canadian and US GAAP.
- Already announced it's not going to pick up proposed new US GAAP rules on accounting for transfers of receivables and consolidations, even though Canadian GAAP in these areas is a carbon copy of existing US standards.
- Said it's unlikely it will require an entity to adopt new IFRS rules on income taxes until the entity changes over to IFRS (although the rules may come out too late to do anything else anyway).

- Made no move to adopt US proposals to simplify hedge accounting requirements or improve contingency disclosure requirements. Right now, existing US GAAP in these areas is, roughly speaking, the same as Canadian GAAP.
- Put a sock in the Emerging Issues Committee ("the EIC") by requiring the EIC to clear new agenda items with the Board before taking them on. To date, the Board has been sparing in its approvals.

Looming on the horizon are new IFRS standards on consolidations, joint ventures and discontinued operations which are supposed to be out in 2009. We're willing to bet significant dollars that the AcSB will defer their application until 2011 as well. After all, if something's on ice, it's on ice. Anyway, what's a year between friends?

Observation. Leave Canadian GAAP alone too long and it's going to start smelling as bad as the leftover salmon hiding behind the lettuce at the back of the fridge. We suspect that this was a significant and perhaps the major reason why the AcSB hasn't responded to pleas to extend the deadline for changeover to IFRS beyond 2011. On the bright side, the AcSB's restraint in changing Canadian GAAP during the transition period maximizes the opportunities for the smoothest transition to IFRS possible in the circumstances. Unfortunately, it also introduces the potential for increasing the extent of differences between Canadian GAAP and IFRS or US GAAP during the transition period. Those with reporting responsibilities under these GAAP's should take care – differences may pop up where you least expect them.

CSA Views on Transitioning to IFRS

I was gratified to be able to answer promptly and I did. I said I didn't know – Mark Twain

The AcSB isn't the only body that affects how a public company transitions to IFRS. The other is the Canadian Securities Administrators, aka the "CSA". In the past few months, CSA staff have set out their views on a number of important matters. We summarize these below.

- **Disclosure in MDA.** Disclose the key elements of your transition plans in MDA, such as the impact on accounting policies, information systems, internal controls, financial reporting expertise, training and the business (including debt covenants, bonus schemes, etc.). The requirements apply starting with 2008 interim and annual MDA but you don't have to have figured everything out yet (the guidance is a bit confusing in this respect). The general principle is, "Disclose what you know and fill in the holes later". As you get closer and closer to transition, staff will expect you to have identified any major differences in accounting policies and eventually to quantify the impact of IFRS on your statements.
- **Early adoption of IFRS.** At least until IFRS is safely in the Handbook and possibly even after that, you're going to have to apply for an exemption. The CSA staff will expect you to have carried out an IFRS readiness assessment before applying for this. It's likely you'll have to include formal representations as to your readiness in the applications and if so, the extent of those representations. We expect the AcSB to import IFRS in the Handbook later in 2008. Stay tuned.
- **Reporting compliance with GAAP.** In staff's view, it would be preferable for securities rules for public companies to prepare financial statements in accordance with IFRS, as published by the IASB ("IFRS-IASB") rather than Canadian GAAP and for auditors to refer to IFRS-IASB in audit reports. However, staff continue to consider issues relating to the availability of an appropriate French translation of IFRS and reference to both IFRS-IASB and Canadian GAAP.
- **US GAAP reporting option.** Canadian SEC registrants can breathe a sigh of relief. You'll not, repeat not, lose your right to prepare financial statements using US GAAP. Staff had proposed killing this option earlier but upon mature reflection, decided not to. Of course, now that the US might be adopting IFRS ...

Observation. CSA staff views on MDA disclosure about IFRS transition plans will have the greatest resonance with companies. We expect that companies planning to change over to IFRS in 2011 will not be able to make definitive disclosures about the impact of IFRS in 2008, and probably not even in 2009 given the number of IFRS standards scheduled for completion in 2010 and 2011. Of course, the sooner you can disclose things the better – readers of your financial statements deserve to know.

IFRS for Extractive and Rate-Regulated Enterprises

If we do not hang together, we will all hang separately – Benjamin Franklin

And now for something completely different – here's a brief status report on IFRS developments affecting extractive and rate-regulated enterprises.

- **Transition rules for full cost accounting.** Under existing IFRS rules, an entity following full cost accounting under Canadian GAAP would be compelled to restate exploration, evaluation, development and production assets. The IASB tentatively has decided to change the transition rules to permit these entities to measure the assets on transition to IFRS by allocating the amount the entity had recognized under full cost accounting. When an entity uses this election, it will have to disclose the basis for that allocation and test the allocated amounts for impairment at the date of transition to IFRS.
- **Transition rules for rate-regulated accounting.** IFRS transition rules also may require Canadian rate-regulated enterprises to restate property, plant and equipment. The IASB tentatively decided to revise the rules to permit these entities to carry forward Canadian GAAP carrying amounts for PPE as their deemed cost for the assets under IFRS. There's a caveat – it must be impracticable to identify the amounts that wouldn't have qualified for capitalization under IFRS.
- **Rate-regulated accounting under IFRS.** The IFRS equivalent of the CICA Emerging Issues Committee, the International Financial Reporting Interpretations Committee ("IFRIC") is doing preliminary research on the fundamental issue of whether regulated entities could or should recognize rate-regulated assets and liabilities under IFRS. Look for IFRIC to discuss whether to add this issue to its agenda soon, perhaps as early as its September meeting.
- **IFRS standards for the extractive industries.** Progress on development of a general IFRS standard for the extractive industries remains slow. We expect a discussion paper summarizing the issues to be released by the end of 2008. Be warned though, the project still is in the research stage. It has not even made its way onto the IASB's active agenda. A final standard will not be in place for many years, certainly not before 2011.

Observation. The proposed transitional exemptions for full cost and rate-regulated accounting are a real win for entities in these industries that have worked hard to understand the applicable IFRS and develop industry-wide solutions. Kudos also to the AcSB for its efforts. We encourage entities in other industries to consider and resolve IFRS transition issues on a collective basis. Two heads or more always are better than one, even in accounting.

Look for an exposure draft proposing the IASB's tentative decisions regarding these transition issues in the next few months and a revised standard in the second half of 2009.

Canadian GAAP for Private Enterprises

Everything should be made as simple as possible, but not simpler – Albert Einstein

When the AcSB decided to change over to IFRS, it promised private enterprises it would develop an alternative GAAP especially for them. Rightly or wrongly, most have interpreted this to mean that private enterprises eventually will be able to follow a kinder and gentler GAAP than the beast everyone else has to wrestle with now.

After several false starts and much hemming and hawing, the AcSB finally has come up with a game plan for developing private company GAAP. Or at least it thinks it has. The aim is to tailor the existing rules as set out in the CICA Handbook, including the basic financial statement concepts. By “tailor” we mean slashing disclosure requirements and subjecting the more controversial bits to a cost-benefit review. These would include financial instruments, consolidation and affiliates, future income taxes, asset retirement obligations, employee future benefits, leases, current/non-current classification, goodwill and intangible assets, and stock-based compensation.

In forming this strategy, the AcSB considered, but rejected, the alternative of adopting IFRS for private entities which the IASB expects to release in 2009. We assume the basis for this strategy will be that private enterprises are more comfortable starting from the Handbook than from IFRS.

Look for the AcSB to consult with preparers, users and others about its approach this fall and winter. If everybody is happy with it, the Board hopes to have an exposure draft of GAAP for private enterprises out by March 2009. The AcSB says the project is its absolute “top priority”.

In passing, we should mention that the AcSB also has been busy softening some of its existing rules on capital disclosures and financial instruments for private enterprises. The relief might not sound like much but it’s substantial.

Observation. It’s a fine balance. The greater the gulf between GAAP for private and GAAP for public enterprises, the more difficulty financial statement preparers, auditors and users will have juggling two GAAP systems and crossing over from one to the other. In our view, there should be close linkage between the fundamental principles used in the two sets of standards. Using the Handbook as the basis for private company GAAP rather than IFRS will make linkage harder to achieve. Still, we believe there are opportunities to simplify GAAP for private enterprises, especially in the area of disclosure. Whether the result will be the kinder and gentler GAAP that many are expecting remains to be seen. The potential for bitterly disappointed expectations is very high.

Fair Value Accounting

FAS 157, Fair Value Measurement, has been blamed for everything from the credit crisis to global warming, from multibillion dollar write downs and forced capital raising to Chien-Ming Wang hurting his foot running the bases – David Zion, Credit Suisse

Fair value accounting has taken some shots during the credit crunch. Some deserved, some not.

One of the more common complaints is that fair value can obscure an asset's intrinsic value when markets go into the dumpster. Advocates of intrinsic value accounting believe that values assigned for accounting purposes should strip out the discounts for risk and uncertainty that market participants demand when market conditions go south. Why? The premise is that these discounts are only temporary in nature and will disappear when markets recover. "This too shall pass" seems to be the thinking. Of course, logic demands that this premise also should apply when markets exhibit "irrational exuberance", to borrow Allan Greenspan's phrase, but no one seems to mind fair value accounting very much when times are good.

Another complaint about fair value accounting is that it's "pro-cyclical". This is a theory where the mere act of writing down assets to fair value in depressed market conditions adversely affects market sentiment, which in turn leads to further price reductions, which further increases write-downs, which ... You get the drift. Those in industries subject to capital requirements, such as financial institutions, experience pro-cyclicality of a different kind. Write-downs reduce capital, which triggers a need to sell assets, which increases supply, which reduces prices ...

So far, standard-setters have held steadfast in their allegiance to fair value accounting and their view of the role it plays in the markets. Using current prices as a basis of accounting trumps intrinsic value any day of the week. Pro-cyclicality? "Accounting didn't create the credit crunch", snort the IASB and FASB, "Bad lending practices did". The not so subtle subtext here, "Don't shoot the messenger."

While there's sharp disagreement on the appropriateness of fair value accounting, standard-setters and the markets agree that the world needs more guidance on estimating fair value when markets seize up, and improved disclosure of the assumptions that underlie fair value estimates. Getting this guidance out is high up on the FASB, IASB and regulators' priority lists. Look for it soon. In Canada, the AcSB has promised assistance on accounting for non-bank sponsored asset backed commercial paper, the most obvious manifestation of the credit crunch in the country.

Observation. We disagree with those who believe that fair value should be suspended or replaced when markets are severely distressed. Our view is that fair value accounting remains the best available method for reporting most financial instruments when accompanied by appropriate disclosure. Not to say that its use should be extended, far from it – the relevance, reliability and practicality of fair value accounting needs to be more fully understood before this happens.

Complexity in Accounting for Financial Instruments

It matters whose ox is gored – Martin Luther

Did you know that there are at least 16 different ways to measure financial assets and eight different ways to measure financial liabilities under GAAP today? Small wonder that one of the top criticisms of existing GAAP is that accounting for financial instruments is way too complicated. As the Chairman of the International Accounting Standards Board likes to say, if you think you can apply the rules on financial instruments, it's only because you don't understand them.

A recent discussion paper from the IASB outlines a number of holistic approaches to fixing the problem:

- Reduce the number of measurement options, or eliminate or simplify the criteria for using them.
- More radically, require measurement of all financial instruments at, you got it, fair value, with some exceptions which would be measured at cost.
- Get rid of hedge accounting altogether or replace it with a simpler and kinder version.

The process of simplifying hedge accounting already has begun. The FASB issued for comment a proposed standard that would make getting hedge accounting a lot easier than it is now. Of course, this won't help companies now using Canadian GAAP. That's because, as we all

know now from reading this newsletter, Canadian GAAP has been put on ice. Those are interim solutions. The FASB discussion paper also proposes a longer term solution – saying the heck with exceptions of any kind and requiring companies to account for all financial instruments using a single basis. What basis, you ask? Why fair value, of course.

Observation. Existing GAAP for financial instruments is the result of 20 or 30 years of piecemeal efforts to address specific instruments and problems. It's hard to be too surprised when the result is a patchwork quilt of different answers and options for different types of instruments. Compounding the problem is that whenever standard-setters propose a straightforward solution, it usually gets mangled beyond recognition as the result of pressure exerted by special purpose groups (including regulators and auditors). Can't have that dearly loved ox getting gored, can we? Time passes and people start grumbling about how hard the rules are, conveniently forgetting that the source of the problem was the complaints about the straightforward principle. Before meaningful progress on complexity can be made, two things have to happen: standard-setters have to stop responding on a piecemeal basis and we're going to have to set our oxen free to fend for themselves.

Not-for-Profit Organizations

He flung himself from the room, flung himself upon his horse and rode madly off in all directions

– Stephen Leacock, *Nonsense Novels*

A few updates on a number of different issues affecting accounting by not-for-profit organizations (“NPOs”).

- **Application of IFRS.** The AcSB proposed that all NPOs be exempt from the requirement to apply IFRS. Look for a final decision later this year when the AcSB finalizes its definition and establishes once and for all who has to apply IFRS and who doesn't.
- **Private enterprise GAAP for NPOs.** If an NPO doesn't apply IFRS, the AcSB may require them to apply Canadian GAAP for private enterprises, which we discussed earlier. Suitably tweaked, of course.
- **Amendments to existing standards.** The AcSB approved a series of amendments to existing standards for NPOs. Of the more important changes, NPOs will have to: (a) apply the guidance on cash flow statements and interim financial statements relating to profit-oriented enterprises, (b) report certain revenues gross in the income statement of operations, (c) amortize the capital assets an NPO reports as assets in its balance sheet, and (d) when an NPO classifies its expenses by function and allocates some of its fundraising and general

support costs to another function, disclose the policy adopted for expenses and the amounts allocated from each of these two functions to other functions.

One proposed amendment was not approved. The AcSB decided not to require NPOs to consolidate controlled entities or make certain other clarifications relating to the identification of control pending the outcome of its deliberations on the future basis for setting standards for NPOs. Under the private company GAAP that might be used for NPOs, consolidation might be optional.

The revised standards are expected in the final quarter of 2008. No word yet on their effective date.

Observation. By far the most important of the various NPO accounting issues the AcSB is addressing is the question of which ones, if any, should be considered to be publicly accountable and therefore be compelled to apply IFRS? The AcSB says none. Explain that to your granny. We don't get it. Surely some NPOs must be publicly accountable?

Emerging Issues Committee Abstracts

Hear that lonesome whippoorwill? He sounds too blue to fly. The midnight train is whining low, I'm so lonesome I could die – Hank Williams

Now that IFRS has come to town, the Emerging Issues Committee has virtually nothing to do. No one wants new interpretations of existing Canadian GAAP that will last for only a few years.

Here are the very few final and draft interpretations released since the last issue of ***Financial Reporting Release***.

EIC 170, Conversion of an Unincorporated Entity to an Incorporated Entity

Changes to tax legislation which make income trusts subject to tax have caused a fair number of trusts to convert into corporations. This Abstract provides comprehensive guidance on the accounting and financial statement presentation issues arising from this.

RD73, Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through

This draft Abstract addresses the computation of future income taxes situations where a trust consolidates a limited partnership in which other investors hold partnership interests that can be exchanged for units of

the trust. The Abstract concludes that the trust should compute future income taxes relating to the partnership assuming the other investors will not exchange their interest. When an exchange occurs, the trust should adjust its future income taxes either by charging equity or increasing the cost of its investment in the partnership depending on certain factors.

D77, Income Statement Presentation of a Tax Loss Carryforward Recognized Following an Unrealized Gain on an Available-for-Sale Financial Asset

Entities that have tax loss carryforwards might recognize an unrealized gain on an asset classified as “available for sale”. As a consequence, the gain would not be included in net income for the period but rather recognized in other comprehensive income (“OCI”). This draft Abstract proposes that, if any tax expense attributable to the gain is offset by the loss carryforward, the tax expense be shown as a charge to OCI but the offsetting credit relating to the loss carryforward be included in net income. This reflects the view that recoveries of unbooked prior years’ tax losses always go to net income regardless of the origin of the income causing their utilization.

Appendix: IASB Projects in the Pipeline

I have been reading Proust for the last three days (and begin to observe the infection of uncontrolled detail creeping into this diary) – Robert Byron, *The Road to Oxiana*

Earlier in this *Financial Reporting Release* we told you the IASB and FASB have accelerated the timetable for completing a number of significant joint projects. The table below sets out the timelines for these and other major projects on the IASB's work plan that we expect to be of particular relevance to Canadian companies planning to convert to IFRS in 2011 or earlier. Want to learn more about individual projects? Check out the following pages.

Project	Expected Issue date	Likely effective date*
Joint ventures	2009	2010
Consolidation**	2009	2011
Discontinued operations**	2009	2011
Fair value measurement guidance	2010	2012
Income taxes**	2010	2012
Income tax uncertainty	2010	2012
Derecognition**	2011	2013
Financial instruments*	2011	2013
Financial statement presentation**	2011	2013
Leases**	2011	2013
Liabilities and equity**	2011	2013
Pensions and other post employment benefits**	2011	2013
Revenue recognition**	2011	2013

* The effective date of amendments and new standards is usually 6-18 months after publication. In appropriate circumstances, early adoption of new standards will be allowed. The dates in the table represent our estimate of the most likely date at which adoption of the new standard resulting from the project will be mandatory. Standards usually are effective as of the beginning of a financial year. For Canadian GAAP implications, see "Canadian GAAP until the Transition to IFRS".

** Standards being developed jointly with the FASB or IFRS and US GAAP in this area are being converged. Other projects on the IASB's work plan include: common control transactions, government grants, insurance contracts (2011), emission trading schemes (2011), IFRS for private entities (2009), liabilities (2010), management commentary, earnings per share (2009), related party disclosures (2008), annual improvements (2009), conceptual framework, first time adoption of IFRS (2009), group cash settled share-based transactions (2009), and extractive industries. The dates in parenthesis refer to the estimated issue date of the standard. If there's no date, the IASB has yet to establish an estimated date for completion of the project.

Appendix: IASB Projects in the Pipeline

Don't be fooled. These projects have the potential to significantly change IFRS. To illustrate – once these projects are completed, companies just might find that under these standards they'll have to:

- Classify all types of preferred shares and stock options as liabilities, leaving only common shares as equity.
- Change long-standing consolidation and revenue recognition practices.
- Retool the accounting for accounts receivable securitization programs.
- Treat all operating leases as liabilities.
- Revise basic financial statement presentation formats, including using standard headings and captions and providing a new statement of “comprehensive income”.
- Provide detailed information about the impact of fair value and other estimates on net income on a line-by-line basis.
- Recognize the full amount of any pension surpluses or deficits on the balance sheet and report pension expense on a more volatile basis than existing GAAP.
- Redo their accounting for financial instruments, purportedly to a simpler model.
- Refine estimates of fair value using principles similar to those found in US GAAP.
- Account for joint ventures using the equity method instead of proportionate consolidation.
- Adjust future income taxes to recognize modifications to existing tax standards.
- Set up tax cushions for possible income tax reassessments using a new model.

Will the timing of these projects affect your transition to IFRS in 2011? Do fish swim? Of the 13 projects listed above, the IASB expects to finalize seven in 2011. We believe it's unlikely these standards will be out in time to allow Canadian companies adopting IFRS in 2011 to incorporate them for first time IFRS reporting (e.g. interim financial statements for the three months ending March 31, 2011). Even if a particular standard is available, you may find you'll have to postpone adoption until later in order to assess its impact on financial reporting and implement its requirements, or because the standard prohibits immediate adoption. Similar issues may exist for standards issued in 2010. If it's not possible to apply a new standard on transition to IFRS, you'll have no choice but to change over using existing IFRS that will have a very short shelf life – the AcSB has said it expects that companies will have until 2012 to adopt standards issued in 2010 and until 2013 for standards issued in 2011. Ugh!

You should be taking into account the possibility of having to adopt new IFRS standards shortly after transitioning to IFRS when developing IFRS transition plans. This could impact how you decide to adopt standards at transition and plans for changing accounting systems and internal controls. While it's possible that the changes might not be important in your particular circumstances, don't leave anything to chance – stay on top of developments.

Appendix: IASB Projects in the Pipeline

<p>Joint ventures</p>	<p>You've heard about all of this before. The IASB is proposing to eliminate the use of proportionate consolidation for most joint ventures in order to bring IFRS in line with US GAAP. Our bet? Proportionate consolidation is a dead duck. It goes without saying that this will have a big impact on real estate and resource industries, particularly in Canada.</p>
<p>Consolidation</p>	<p>The credit crisis has shone a new spotlight on the adequacy of existing consolidation standards, particularly those for special purpose entities. The FASB is patching some of the larger holes in the SPE consolidation rules it rushed out in response to Enron – these will be applicable for US GAAP starting in 2010. The IASB seems to think its existing rules only need a bit of tinkering here and there and will form an appropriate basis for a converged IFRS-US GAAP standard. Hmmm ... We'll see.</p>
<p>Discontinued operations</p>	<p>This project is supposed to change the criteria for applying discontinued operations accounting ("DOA" – pun intended). DOA accounting involves presenting revenues and expenses and cash flows of discontinued operations net on a single line and segregating the related assets and liabilities on the balance sheet. Under existing GAAP you have to apply DOA for the disposal of almost every component of a business, no matter how small, if certain criteria are met. This approach hasn't proved to be a real winner – too messy. The Boards now are considering reserving DOA to disposals of "operating segments" (those chunks of the business that are so important that the head honcho reviews their results personally) and lesser components acquired as part of a business combination.</p>
<p>Fair value measurement guidance</p>	<p>This project answers the question "What's fair value anyway and how do I go about measuring it?" Sound a lot like the now infamous US standard, FAS 157? You bet it does. The IASB has kicked off this project by issuing FAS 157 as a discussion paper and doing some more navel gazing on what fair value really is and whether to call fair value, fair value or something else. Navel gazing takes time. Unless the IASB picks up the US standard lock, stock and barrel, this one will never see the light of day by 2011. No way. No how.</p>
<p>Income taxes</p>	<p>This project was originally designed to harmonize IFRS and US GAAP but there's now some talk that the US won't make any changes in light of the prospect that the US will be moving to IFRS. The new standard will require companies to recognize deferred income taxes in some areas that are now exempt. Changes could be significant. The new standard will include a new definition of the term "substantive enactment", which is the trigger date for recognizing the changes in tax laws. Our understanding is that the new definition shouldn't trigger "substantive" changes to Canadian practices.</p>

Appendix: IASB Projects in the Pipeline

<p>Income tax uncertainties</p>	<p>The IASB and FASB have never seen eye to eye on accounting for income tax uncertainties, partly because of the interaction with other standards. The essential issue here is when should an entity set up a tax cushion for possible income tax reassessments, and how should the tax cushion be measured? The IASB proposes a “probability adjusted expected outcome model” (e.g. if it’s 50% probable you’ll lose \$100 and 50% probable you won’t, set up \$50). Nowhere near existing US GAAP. The IASB model, of course, guarantees that whatever amount you set up on Day One won’t be the amount you’ll have to pay.</p>
<p>Derecognition</p>	<p>Derecognition is the fancy term accountants use to describe removing an asset (or liability) from the balance sheet. Existing GAAP in this area is a mess no matter where you look, especially for accounts receivable securitizations. The heart of the problem is establishing appropriate criteria to determine when sales in legal form are really borrowings in disguise. Right now, IFRS makes it almost impossible to get sales treatment for securitizations but the rules are such a conceptual embarrassment that accountants shuffle their feet and start their sentences with “Geez, you know ...” whenever they’re asked to explain them. The opposite is true in North America – there’s a conceptual basis but the regulations are such a lawyer’s delight that sales treatment almost always results, even when a transaction smells, tastes and feels like a borrowing. The FASB is trying to plug the largest loopholes for US GAAP by 2010.</p>
<p>Financial instruments</p>	<p>We’ve cheated a bit here. The IASB actually hasn’t established 2011 as the date for completing this project. We’ve put it in the 2011 column because the Chairman of the IASB said replacing existing standards for the recognition and measurement of financial instruments is a must for converging with the US. The object of the exercise? To make existing GAAP in this area understandable to people other than nuclear physicists and philosophers. Refer to the discussion in the body of Financial Reporting Release, “Reducing Complexity in Accounting for Financial Instruments”, for a discussion of the Boards’ initial musings in this area.</p>
<p>Financial statement presentation</p>	<p>The IASB and FASB started this project with revolution in their bellies and fire in their eyes. The idea was to get rid of the concept of other comprehensive income (“OCI”) once and for all. OCI is the holding tank standard-setters dreamed up to accumulate gains and losses that no one wants to recognize in net income. So much for revolution. The IASB and FASB have put this issue on the back burner for now to get the remainder of the project done by 2011, a grab bag of things such as getting rid of the concept of cash equivalents, highlighting the impact of estimates on individual items of revenue and expense, disclosing the maturities of short-term liabilities, and reporting a separate statement of comprehensive income that would segregate the operations of the business into the following categories – business (operating and investing), financing, income taxes and discontinued operations. You’d use these captions in the balance sheet and statement of cash flows as well, so the statements would talk to one another.</p>

Appendix: IASB Projects in the Pipeline

Leases	Make no mistake – when this project is done, lessees will have to account for all operating leases as borrowings. No if's, and's or but's. Other aspects of lease accounting might also change, e.g. having to include estimates of future contingent rent payments in the amount set up as the borrowing. We confidently predict no grandfathering. What's that you say? Same deal for lessors? Nope. The accounting for lessors is being held up so the Boards can fix the accounting for lessees by 2011. Why does the phrase "half-baked" spring to mind?
Liabilities and equity	Existing IFRS and FASB criteria for distinguishing liabilities and equity are as different as chalk and cheese. There's another problem – only three people in the world have ever fully understood this GAAP and two of them are dead. The FASB recently issued a discussion paper that reviews three possible alternative models. The leading contender at the moment is one that would result in only common shares and similar interests being equity. Everything else would be a liability, even perpetual preferred shares and stock options. The model is simple but suffers from a rather large flaw – basic financial statement concepts say that equity is anything that's not a liability, not the other way around. Will the FASB and IASB gulp hard and make this model GAAP? Who knows, but 2011 is a pipedream if it doesn't.
Pensions and other post-employment benefits	Accounting for pensions (and other post-employment benefits) is a pain in the butt, always has been and always will be. The IASB recently issued a discussion paper which would require entities to report the full amount of a plan's surplus or deficit as an asset or liability in the balance sheet, which is what US GAAP requires now. The paper also proposes elimination of deferral and amortization of past service costs and changing the way pension expense is calculated. Three different alternatives have been proposed for the latter, each with very different impacts on income statement volatility. Which alternative does the IASB prefer? Discretion before valour.
Revenue recognition	This project would replace the 4,382 models for recognizing revenue under today's GAAP with a single generic model. Right now, the Boards are thinking that an entity would recognize revenue under a contract when the entity performs its obligations. If a contract requires the entity to do different things, the entity would allocate the contract price to each performance obligation. Gee, this sounds so simple it's got to be hard.

For more information ...

This newsletter has been prepared for the clients and friends of PricewaterhouseCoopers by our Professional, Technical, Risk and Quality Department. For further information on any of the matters discussed, please feel free to contact any member of the department, or your PricewaterhouseCoopers engagement leader. This newsletter is available from the PricewaterhouseCoopers LLP Canadian web site, which is located at www.pwc.com/ca.

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