Financial Reporting Release

Keeping your head above water…

Recent issues in financial reporting*

August 2009

In this Issue

If you want to make God laugh, tell him your future plans – Woody Allen

It's been a busy time for accounting the last few months. Standard setters, egged on by politicians and regulators alike, are busy patching the holes in accounting that the financial crisis uncovered. Financial instruments, fair value, impairment, consolidation, asset derecognition, and disclosures are among the priorities. Where are things going? When will they happen? Will you be happy? Will you be sad? Will the Blue Jays wind up in the cellar? We have answers to at least some of these questions.

Financial crisis or not, Canada's Accounting Standards Board ("the AcSB") is moving full steam ahead with its plan to transform the shape of financial reporting in Canada, including the requirement that Canadian publicly accountable enterprises adopt International Financial Reporting Standards ("IFRS"). No one can hide – everybody's got to change. We've got the latest developments and explain what you should be doing now to avoid bad things happening at transition.

While Canada converges with IFRS, controversy and debate continues to swirl over whether and when the US will do the same. IFRS stakeholders are beginning to get upset about US dilly-dallying. Is the dream of global GAAP convergence dead? We give our views here.

And there you have it. Happy reading.

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The Future of Canadian GAAP

Time's fun when you're having flies – Kermit the Frog

Parents of a certain vintage will remember a song from a kids TV show called "The Song that Never Ends". Played over the closing credits, the tune went on and on, enchanting the kiddies, perhaps, but causing the parents to grind their teeth, roll their eyes, and wonder whether having children really was such a good idea after all.

This ditty came to mind in preparing this edition of *Financial Reporting Release*. "Gee", we thought, "we've been talking about the future of Canadian GAAP a long time". Take heart. You may not be hearing this particular tune too much longer. As we write, Canadian standard setters are putting the finishing touches to their plans for revolutionizing Canada's financial reporting regime, including, of course, the requirement for publicly accountable enterprises to convert to IFRS. Take a quick look at the Table on this page to see the grand design.

Unless you're dead or in a coma, you'll know the date for transitioning over to the new financial reporting regime is 2011. This timing is less than propitious for those converting to IFRS because the International Accounting Standards Board ("IASB") is planning to make significant changes to IFRS over the next few years. Changes to standards it hopes to get out by 2011 include financial instruments, impairment, fair value, hedging, consolidation, derecognition, financial statement presentation, debt versus equity, income taxes, joint ventures, liabilities, pensions, leases and revenue recognition. While many of the changes wouldn't be mandatory for 2011, deferring adoption until after transition would mean having to adopt old IFRS at transition and catching up with the revisions later – the dreaded double switcheroo. If you're guessing that the prospect of these changes might cause a deferral of the 2011 cross over date, guess again. The AcSB made a special announcement on this in May. Loosely translated it says, "Read our lips, the date's not changing".

Timelines are shorter than they appear, particularly for IFRS. True, you have to start reporting under IFRS only in 2011 but you'll need 2010 comparatives. To have comparatives, you'll have to prepare a balance sheet that transitions from existing Canadian GAAP to IFRS as at the start of 2010. While, technically, you don't have to complete this until 2011, it's a good idea to start sooner rather than later. You'll need to have established appropriate processes and policies to capture required information on a timely basis. And for goodness sake, whatever you do, don't overlook the designation and documentation requirements for optional accounting treatments (e.g. hedging and financial instrument measurement). Unless these choices are all in place by the start of 2010, you'll lose your right to apply those treatments in your transitional balance sheet.

Observation. Our advice? Make sure you understand where you are in your transition process now and review your timelines carefully. We'd hate for your new song to be a sad one.

Canada's Proposed New Financial Reporting Regime

Publicly accountable enterprises	IFRS, US GAAP optional for SEC registrants
Pension plans	Modified version of existing standards for pension plans supplemented by specific IFRS
Non-publicly accountable enterprises	Simplified made in Canada GAAP for private enterprises (see later discussion), IFRS optional
Not-for-profit organizations	GAAP for private enterprises supplemented by existing Canadian GAAP requirements for NPOs, IFRS optional
Government organizations	IFRS for business enterprises, GAAP for NPOs (see above) for government NPOs and IFRS or existing Handbook guidance, as appropriate, for others

Crossing Over to IFRS

Don’t force it, get a larger hammer – Anthony’s Law of Force

We need to keep playing the IFRS conversion song for just a few more minutes – there’s more you need to know. In May, Canadian Securities Administrators (“CSA”) issued proposals about first-time interim IFRS financial statements. In July, the IASB provided relief to further simplify the transition to IFRS for some, including Canadian oil and gas companies that apply the full cost method. The highlights are as follows.

CSA proposals

- It’ll be necessary to include a balance sheet that transitions from Canadian GAAP to IFRS in first-time IFRS interim statements. For those with calendar year ends, the transitional balance sheet usually will be as at January 1, 2010.
- Your auditors will have to review that balance sheet, or you’ll have to include a note saying that they didn’t.
- Interim financial statements must include disclosure that you’ve complied with IFRS requirements for interim financial statements.

The CSA also said that if you want to use IFRS before 2011, you’ll have to get their okay. Once transitioned, references in financial statements, and in auditors’ reports, to the basis of preparation of your financial statements will need to be either to IFRS, or to both IFRS and Canadian GAAP. Can’t just say Canadian GAAP.

The CSA notice also acknowledges the challenges confronting issuers in transitioning to IFRS. Staff are considering ways in which it might provide assistance, including deferral of the date for filing initial interim reports. Look for another set of CSA proposals to come out in the next few months.

Don’t forget, by the way, existing CSA requirements to disclose the status of IFRS transition plans in the MDA. As the transition date grows nearer, the CSA is expecting you to provide more details.

IASB transition relief

The IASB transition relief allows oil and gas companies using the full cost method to reallocate full cost pools to individual assets rather than reconstructing what the cost of the assets would be on a stand-alone basis or valuing them at fair value. Other relief allows IFRS converters to rely on previous GAAP assessments as to whether an arrangement represents a lease. Be warned. There’s some ambiguity over the applicability and limitations of this relief. Consultation with advisors would be a good idea.

Observation. Even though IFRS doesn’t require the inclusion of the January 1, 2010 transition balance sheet in first-time interim IFRS financial statements, the CSA believes that this will assist users’ understanding of the impact of the change over. It’s a “more is more” kind of thing. As to the IFRS transition relief, we welcome it. After all, you shouldn’t be striving for perfection in converting to IFRS, only a reasonable approximation of reality.

Canadian GAAP for Private Enterprises

And now for something completely different – Monty Python

We mentioned earlier that under Canada's new financial reporting regime, private enterprises will have the choice of applying either IFRS or a simplified "made in Canada" GAAP. In April, the AcSB released its exposure draft of those standards. Here are the main bits.

- The board's approach was to start with existing Canadian standards and scrap, keep, or prune each depending on their relevance, cost and benefit. The exposure draft halves current GAAP disclosures and places significant emphasis on professional judgment and accommodating private users' needs.
- The exposure draft carries forward many of the differential reporting options in existing GAAP, but without any need to obtain the consent of shareholders to use them. For example, you can account for significant influence investees and joint ventures at cost or using the equity method. Ditto for subsidiaries – consolidation isn't mandatory. Nor are deferred taxes.
- Some of the standards that now apply to private companies have been significantly changed, including financial instruments which will have to be measured at cost or amortized cost with only two exceptions – you'll have to measure free-standing derivatives at fair value and equity investments quoted in an active market at their quoted price. You can't separate embedded derivatives (except for the embedded equity option in a convertible debt, where you'll have the choice). Applying the new business combination rules introduced into GAAP in the past year or so is mandatory, but there'll be no need to assess goodwill annually for impairment, only when events or circumstances arise that suggest it might be impaired. You'll have the choice of capitalizing development costs and internally generated intangibles. One choice will be eliminated – the right to exclude volatility in calculating stock-based compensation expense.
- The proposals add a couple of new disclosures about government remittances and key management compensation. The results of the IASB's projects on consolidation and derecognition are also likely to find their way into the final guidance in some form or other.

The proposed effective date is for fiscal years beginning on or after January 1, 2011 with retrospective application, except for a few particularly burdensome areas. The board intends to allow early adoption and hopes to have final guidance issued in time for application to 2009 calendar year-end financial statements.

Observation. Private companies have got decisions to make – whether to adopt IFRS or private company GAAP and, if the latter, which of the many options in the proposed guidance to apply. Depending on your choices, the financial statements you end up with could be as different as chalk and cheese. In deciding which way to go, a good starting point would be to consider the needs of your financial statement users and your ability to accommodate those needs under the available alternatives. Think about this. Hard. The financial statements you save may be your own.

Reflections on the Financial Crisis

Narrator: "Will Bullwinkle be able to extricate himself?"
Bullwinkle: "I will just as soon as I get these ropes off." – Rocky and Bullwinkle

Crises generally breed sober reflections of what went wrong and how they can be fixed. Accounting is no exception. Late in 2008, the IASB and FASB ("Boards") formed the Financial Crisis Advisory Group to consider the standard setting implications of the financial crisis. Group members are senior leaders with broad international experience.

The Group issued its first report late in July. The report provides a useful overview of the stresses, strains and tensions that accounting has been under during the crisis. While the report focuses primarily on financial institutions, it'll have wider implications. A summary of some of its most important conclusions and recommendations is set out below.

- The financial crisis has underscored the complexities and difficulties in applying financial instrument standards, including estimating fair value in illiquid markets and having to apply multiple asset impairment models. The Boards' priority should be to simplify and improve these standards. Areas where immediate improvements are necessary are consolidation, derecognition of financial instruments, changes in the fair value of an entity's own debt, and financial instrument risk disclosures.
- Businesses, especially financial institutions, should employ effective price verification processes and otherwise improve the valuation of assets and liabilities.
- Governments and regulators placed excessive pressure on accounting standard setters during the financial crisis to make rapid and piecemeal changes outside of their normal due process. While policymakers can and should voice concerns and provide input, they should refrain from seeking to prescribe specific outcomes.
- The independence of the IASB should be strengthened by securing permanent and independent funding arrangements and broadening the geographic representation on the IASB's oversight body.
- Global markets require a single set of high quality accounting standards. National governments that haven't already done so should set a practical and firm timetable for adopting or converging with IFRS.

Observation. As we'll see in the following pages, the Boards already are working on an expedited basis to rework financial instrument and other standards identified by the group for improvement. Other issues raised will be harder to address. Take interaction with policymakers, for instance. If there's one thing that the financial crisis has highlighted, it's that standard setting can't be divorced neatly from political and regulatory processes. We support the formation of new consultative procedures that will lead to constructive and meaningful dialogue with policymakers and standard setters, and where possible, the development of accounting standards and disclosures that appropriately addresses policymakers' concerns. Global GAAP convergence is possibly the hardest nut to crack. So much so that it's the topic of a separate discussion on the following page.

Global GAAP Convergence

Forget, forgive, conclude and be agreed;
Our doctors say this is no time to bleed – Richard II, Act 1, Scene 1

Global financial markets would best be served by a single set of high quality accounting standards. So says everyone, including the G20, the US Treasury and, as we've just seen, the Financial Crisis Advisory Group. The issue, it seems, is not whether global GAAP convergence is a worthy concept; rather, it's how to get there.

The practical reality is that convergence can only happen if IFRS and US GAAP merge in some way. The fastest and most effective way of doing this, of course, would be for the US to adopt IFRS (there being as much enthusiasm for using US GAAP in the rest of the world as there is for root canals). Despite promising signs the US might convert to IFRS, recent events have dimmed the prospects of this happening in the near term. Consider:

- The SEC has deferred making a decision whether to adopt IFRS for US public reporting until at least 2011.
- The new chair of the SEC has expressed some reservations about IFRS, citing the cost of conversion and consistency of implementation, as well as the independence of the IASB.
- There was not an overwhelmingly enthusiastic response in the US to the SEC's request for comments on its proposed roadmap for requiring US public companies to change over to IFRS.
- The FASB has identified political and environmental challenges to conversion and provided academic research indicating that there's not much benefit to the US moving over to IFRS.

The alternative to the US adopting IFRS would be to continue and expand existing programs to converge US GAAP and IFRS in major areas. Even here we see troubling signs.

- The European Federation of Accountants has called for the IASB to cease convergence efforts on the basis that convergence has reached the point of diminishing returns and is adversely affecting the stability of IFRS.
- The chair of the IASB has observed it's unlikely the IASB would participate in new projects to converge IFRS and US GAAP absent a specific commitment from the US to adopt these standards.
- The chair of the FASB has said that converging IFRS and US GAAP on a piecemeal basis would take 10 to 15 years.

Observation. We told you global GAAP convergence is a tough nut to crack. Even so, we continue to strongly support the convergence with IFRS in the US. While the financial crisis has slowed progress, we still expect convergence over the longer term.

Financial Instruments

I'm writing a book. I've got the page numbers done – Stephen Wright

For a long time, a very long time, financial instrument accounting has been way too complicated. To paraphrase the Chairman of the IASB, if you think you understand it, it's only because you haven't read the rules hard enough. The financial crisis only underscored the difficulties inherent in applying existing FI standards – and the need for a solution.

Simplification efforts are now moving full steam ahead. Both the IASB and the FASB are considering new models that extend the measurement of financial instruments at fair value and recognize changes in fair value in net income as they arise. How does this reduce complexity, you ask? By reducing the need for different measurement classifications (held-for-trading, available-for-sale, etc.), multiple impairment models, embedded derivative searches, and the recycling of gains and losses from other comprehensive income, that's how.

A quick glance at the Table on this page reveals an unsettling feature of simplification efforts – the IASB and FASB are pursuing different FI models. Radically different. No word yet if, when and how these differences might be sorted out. The IASB aims to have a new FI standard on classification and measurement ready for use in 2009 (an exposure draft is already out), and new standards on impairment and hedging are scheduled for 2010. However, nothing would be mandatorily effective until 2012 at the earliest. The US is moving only a little slower – look for a final standard covering all aspects in 2010.

The AcSB issued an exposure draft proposing not to incorporate the IASB's initial proposals into Canadian GAAP before the cross over to IFRS.

Observation. We are reviewing the IASB's exposure draft and will be responding to it, but one thing seems reasonably clear already – divergence between IFRS and US GAAP in this area can't be in anyone's best interest. There are already calls for the two Boards to get together on this one. You can add ours to the list.

Comparing the FI Classification and Measurement Models Being Considered by IASB and FASB

Issue	IASB	FASB
Assets and liabilities that must be measured at fair value	All assets and liabilities except for those with basic loan features managed on a contractual yield basis	All except for liabilities where measurement at fair value results in an accounting mismatch
Assets and liabilities that may be measured at cost (fair value optional)	The above exceptions	The above exceptions
Account separately for embedded derivatives?	No	No
Instruments measured at fair value whose changes in fair value must be recognized in net income	All except for investments in equity securities	All except for debt instruments held for the collection of cash flows
Instruments measured at fair value whose changes in fair value may be recognized in OCI	Investments in equity securities (related dividends also included in OCI)	Debt instruments in a portfolio held for the collection of cash flows (related interest is excluded from OCI)
Recycle gains and losses from OCI to net income	No	Yes

Fair Value Measurement

Torture numbers and they'll confess to it – Gregg Easterbrook

Considering the prior page, was there any doubt about what our next topic would be?

Explaining what fair value is and how to estimate it always has been a challenge. Many find the chore to be like trying to grab soap in the bath – "Aha", you say, "Got it", only to find that it pops away, skittering to some unreachable spot behind your back.

The latest organization to have a whack at an explanation is the IASB, which issued an exposure draft this spring on how to measure fair value. Don't hold your breath for any blinding new revelations, though. The IASB borrowed, word for word, the FASB's definition in its now infamous standard, FAS 157. The IASB also picked up the rest of the guidance in FAS 157, though it couldn't resist proposing some tweaks here and there. The IASB's version, when final, will come to Canada only when we transition to IFRS. Be warned. The new requirements might change some measurements under existing Canadian GAAP.

While some of the details in FAS 157 might be different from existing Canadian GAAP, the basic concept of fair value is the same – the fair value of an asset is the price that would be received on the sale of an asset in an orderly transaction between unrelated market participants, both of whom are assumed to be well versed on the asset and neither of whom is under any pressure to act.

While GAAP, everywhere, says that quoted prices in active markets provide the best evidence of fair value, this was disputed during the financial crisis. Some allege that in a crisis market prices are more symptomatic of panic in the streets and fire sale transactions than the result of orderly transactions. Nevertheless, both the FASB and IASB have emphasized the need to take recent market prices into account in making fair value estimates unless it can be concluded that the prices result from forced transactions. Both boards, however, have issued guidance for determining when reliance on market prices without adjustment may not be appropriate. The FASB issued more guidance in June, after being urged, loudly, by the US Congress to do so. The IASB and AcSB didn't incorporate this guidance into their standards on the grounds that it was already there, implicitly if not explicitly.

Observation. There's a subtle but fundamental point that lies at the heart of the accounting concept of fair value – fair value is the ideal price arising in an exchange between a hypothetical buyer and a hypothetical seller. Actual exchange prices don't necessarily represent fair value because the buyer and seller might not have all the attributes of the ideal buyer and seller. Searching for fair value thus is kind of like searching for the Holy Grail. Even if you think you've found it, you'll never be absolutely sure it's the real thing and others may have different ideas about what it is.

Fair Value and Liquidity Disclosures

I'm all in favour of free expression provided it's rigidly kept under control – Alan Bennett

Not only did the IASB reach into the FAS 157 bag for measurement guidance, it also plucked out a requirement for entities to classify assets and liabilities reported at fair value on the balance sheet according to the quality of the assumptions and other inputs used in their valuation. There's a three-level hierarchy:

- Level 1 – is for fair value measurements that use quoted market prices in active markets.
- Level 2 – is for fair value measurements that use mostly observable market data such as interest rates, foreign exchange rates and other market prices.
- Level 3 – is for fair value measurements that depend significantly on management assumptions that can't be verified by reference to observable data.

The objective is to provide more transparency to investors about the relative reliability of fair value estimates.

At the same time, the boards also clarified existing liquidity disclosure requirements – the information about the amount and timing of future payments. Turns out that the existing rules were ambiguous with the result that disclosure was all over the map. Not a good thing, especially during a market meltdown.

The new disclosures are effective under Canadian GAAP for annual financial statements for years ending after September 30, 2009. For an entity with a calendar year-end, that means this year's annual financial statements. So get ready.

This is only the beginning. You can expect to see more changes to financial instrument and fair value disclosure requirements. For example, the IASB is proposing to require more fair value disclosures in interim financial statements, something the FASB has already mandated. Having said this, it's unlikely that additional financial instrument disclosures, other than those set for 2009, will find their way into Canadian GAAP before the cross over to IFRS happens.

Observation. It's become the fashion these days to bemoan the state of financial instrument disclosure – too much, too complicated, and too late are recurring themes. Some may believe that adding these new requirements, regardless of their individual merits, will only make things worse. We understand and sympathize with the frustration. Of course, some of the problems with existing disclosure requirements arise because of the complexity of the current accounting model for financial instruments. Simplifying the model should result in more straightforward disclosure. We hope.

Investments in Debt Securities

Gentlemen prefer bonds – attributed to Andrew Mellon

This issue primarily affects financial institutions. If you're not interested, feel free to yawn, scratch where it itches the most and turn the page. We understand.

One thing that's stayed at rest for a real long time is the accounting in Canada and the US for impairments in investments in debt securities. These are investments in publicly traded government bonds, corporate bonds, commercial paper, residual interests in securitizations, etc. Notwithstanding that these investments look, taste and feel like loans, you've always had to recognize and measure impairments in them on a different basis, using fair values. By contrast, under loan accounting, you evaluate impairment using expected cash flows (discounted at the original effective interest rate on the loan). Big difference.

You'll recall from the last issue of *Financial Reporting Release* (you do remember these, don't you?) that the IASB and FASB floated the idea of companies disclosing what net income would be had investments like these been accounted for as loans under existing GAAP, and also, if both loans and investments had been accounted for at fair value. When the world turned its nose up and thumbs down to this idea, the FASB, under heavy pressure from regulators, fast-tracked a different solution. The result is that US GAAP now permits an entity to account for impairments in investments in debt securities on the same basis as for loans, subject to meeting certain conditions.

The IASB didn't move in tandem with the US on this change. That's because under existing IFRS, you already apply loan impairment principles in accounting for investments in debt securities unless the investment is classified as available for sale. In that latter case, a version of the fair value impairment model applies. This exception has provoked dark mutterings from some IFRS stakeholders about now being disadvantaged relative to their US counterparts.

In Canada, after much debate, the AcSB elected to realign Canadian GAAP to bring it closer to IFRS. As a result, US GAAP differences will be popping up in respect of accounting for impairments in investments in debt securities that remain classified as available for sale. Still, if you're a financial institution, three-quarters of a loaf…The Canadian GAAP changes are mandatory for annual financial statements relating to fiscal years beginning on or after November 1, 2008. Early adoption is allowed for interim financial statements issued on or after August 20, 2009. Be warned. The mechanics of the changes might be tricky.

This story's not over, by the way. Standard setters now are looking at ways of changing standards to accelerate the timing of recognition of loan impairment losses. Look for resolution of this issue as part of the Boards' work on revamping the accounting model for financial instruments.

Observation. If you're wondering why it's fine to account for impairments in loans and investments in debt securities based on expected cash flows while fair value is the rule in accounting for impairments in other assets, such as equity investments, fixed assets and intangibles, it's because standard setters see a sharp distinction between financial assets having contractual cash flows and other types of assets. Happy now? Didn't think so.

Consolidation and Asset Derecognition

I know the answer. The answer lies within the heart of all mankind! The answer is twelve? I think I'm in the wrong building – Lucy (sitting in school), *Peanuts*

Remember Enron? That scandal sparked the creation of new consolidation standards in Canada and the US for a new breed of cat called "variable interest entities", VIEs for short. Those standards were supposed to put an end, once and for all, to games people were playing to avoid consolidating entities that common sense said should have been.

Who said, "Never say never"? In June, the FASB released significant revisions to the VIE rules. Turns out lots of entities still were weaving and bobbing their way around the requirements.

Under the revisions, you're now supposed to decide whether you should consolidate a VIE based on the power you can exercise over the entity and the extent of risk exposures you have. No more complex number crunching about the cash flow variability you're absorbing through your interest in the VIE. It's all down to judgment now.

Consolidation, of course, is only one way of playing off -balance sheet games. Asset derecognition is another, where it takes the form of treating an asset transfer as a sale when, in substance, it's a borrowing. In the US, shocked and horrified about how its existing requirements were being applied, the FASB fast-tracked substantial changes to its standards. One of the major consequences of the changes is that it'll be much harder, though not impossible, to account for accounts receivable securitizations as sales. By the way, we should point out that existing Canadian GAAP in this area is the same as old US GAAP.

So what about IFRS? You'll recall from our last edition that the IASB recently issued exposure drafts of new standards in these areas. Their proposals differ in some respects from the standards the FASB just issued, as well as existing Canadian GAAP. For example, under the proposed approach that the IASB prefers, it'll be even harder to account for securitizations as sales than it is under the new US guidance.

In Canada, existing Canadian GAAP, warts and all, will continue to apply until 2011. This timing will affect Canadian SEC registrants not planning to adopt IFRS because the new US rules on consolidation and derecognition are effective for US GAAP purposes in 2010. As a result, it'll be necessary to consider the impact of the new requirements in US GAAP reconciliations.

Observation. We seem to be falling into a rather depressing pattern of late. Questionable application of accounting principles followed by scandal followed by new principles followed by abuse. Where's it all to end? The difference this time, we're told, is that the new standards are more principles-based and therefore, less likely to admit abuse. We'll see if these new answers are any better than the old ones. It would be folly, we think, to assume that more principles will stop the unprincipled any more than the old requirements did.

Rate-Regulated Activities

I was very restless, but finally I found my way – Emma Bonino

Breathe a sigh of relief, you rate-regulated entities out there. It's out. The IASB issued an exposure draft on accounting for rate-regulated activities. The exposure draft is in direct response to fears raised by Canada and other countries adopting IFRS that the absence of a specific IFRS standard addressing the effects of rate regulation meant you could never, ever, recognize assets and liabilities arising from these activities.

Not so, according to the exposure draft. Under its proposals, an entity carrying out qualifying activities would:

- Generally set up an asset for incurred costs anticipated to be billed in the future or a liability to return amounts collected in advance from customers.
- Measure that asset or liability at the present value of amounts expected to be received or paid (including the effects of any uncertainty about whether the regulator will permit recovery or require payment).
- Make extensive disclosures about the nature and financial effects of rate regulation.

There are differences between the exposure draft and existing practice in Canada – it's therefore likely that significant adjustments will pop up on conversion to IFRS, especially relating to the measurement of rate-regulated assets and liabilities.

The IASB's timetable calls for the release of a final standard in 2010. While the deadline might be tight for those of you crossing over to IFRS in 2011, take heart – at least it now looks like there'll be something you can cross over to.

Observation. We're very glad to see the IASB address this issue. The uncertainty over the application of IFRS on this fundamental question needs to be resolved as quickly as possible.

Income Taxes

I'm spending a year or two dead for tax reasons – Douglas Adams

Slipping by almost unnoticed in the furor over the financial crisis was the release in the spring of an exposure draft of a proposed new IFRS on accounting for income taxes. While the stated purpose of the exposure draft is to harmonize IFRS and US GAAP on some rather technical matters, it's a significant re-write of the existing IFRS tax standard. This means, of course, that those responsible for applying the standard will have no option but to read and consider the whole darn thing again.

From a Canadian perspective, significant features of the exposure draft include the following:

- Significant adjustments to deferred tax balances for assets whose tax basis is different if you sell the asset than if you use it.
- The requirement to accrue income taxes using "substantively enacted" tax rates and laws. While existing Canadian GAAP has the same principle, the exposure draft includes a different definition of the term. There's a concern that tax rates and laws become substantively enacted much later on in the legislative process under this definition.
- A requirement to accrue a liability for uncertain tax filing positions using a weighted average probability method (e.g. if the likelihood is 50:50 that an entity will not be able to sustain a tax filing position of $100, you'd book a cushion of $50). This model is different than the one required under US GAAP. Existing Canadian GAAP doesn't require the use of a particular model and practice varies.
- The elimination of some of the exemptions in existing Canadian GAAP from having to recognize deferred taxes.

The IASB timetable calls for issuance of a final standard in 2010, though there's no effective date yet. There are no plans to introduce the standard into Canadian GAAP in advance of the cross over to IFRS.

Even though the purpose of the new standard is to harmonize with US GAAP, the FASB doesn't have any current plans to adopt its requirements.

Observation. The feedback on the exposure draft has been very negative, in some cases vitriolic. We wouldn't be surprised to see this project dropped or, dare we say it, deferred.

Earnings per Share

The right word may be effective, but no word was ever as effective as a rightly timed pause
– Mark Twain

In the last edition of *Financial Reporting Release*, we issued a warning that Canadian GAAP for the calculation of earnings per share ("EPS") might change soon. We were wrong. Well, not quite wrong, perhaps, but the changes aren't going ahead, for awhile anyway.

The original plan called for Canada to introduce changes to existing GAAP for EPS once the IASB and FASB revised their own standards in 2009. The ultimate goal was to simplify EPS calculations and to pick off some low-hanging fruit from the GAAP conversion tree. The IASB dropped its plans when the financial crisis really took hold and other projects, became the priority. EPS simplification and convergence looked trivial by comparison.

The IASB now doesn't plan to reconsider EPS until 2010. So, any changes to Canadian GAAP won't happen until Canada converges with IFRS.

Observation. One might argue that we've always had better stuff to do than this.

Emerging Issues Committee Abstracts

Only one EIC Abstract has been issued since the date of our last issue.

EIC-174 Mining Properties

This Abstract provides guidance for determining when exploration costs can be capitalized and, if such costs are capitalized, when it's appropriate to undertake an assessment to determine when and whether it's necessary to write down the costs as impaired. The EIC concludes that capitalization is appropriate only if the costs have characteristics of property, plant and equipment and impairment analysis must consider existing Handbook guidance for impairments of long-lived assets. The Abstract is effective for financial statements issued after March 27, 2009.

For more information …

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The partners and managers in our Professional, Technical, Risk and Quality Department are:

Name	Phone	Email
Carolyn Anthony	416 815 5266	carolyn.anthony@ca.pwc.com
Scott Bandura (Calgary)	403 509 6659	scott.bandura@ca.pwc.com
Martin Boucher (Montréal)	514 205 5415	martin.boucher@ca.pwc.com
Sean Cable (Florham Park NJ)	973 236 4958	sean.c.cable@us.pwc.com
Gord Cetkovski	416 814 5716	gord.cetkovski@ca.pwc.com
Michel Charbonneau (Montréal)	514 205 5127	michel.a.charbonneau@ca.pwc.com
David Clément (Montréal)	514 205 5122	david.clement@ca.pwc.com
Lucy Durocher	416 869 2311	lucy.durocher@ca.pwc.com
Agnes Dykstra	416 941 8203	agnes.dykstra@ca.pwc.com
Larissa Dyomina	416 869 2320	larissa.dyomina@ca.pwc.com
Will Foster	604 806 7183	william.p.foster@ca.pwx.com
Sophie Gaudreault	416 815 5236	sophie.gaudreault@ca.pwc.com
Doug Isaac (Vancouver)	604 806 7710	douglas.c.isaac@ca.pwc.com
Celeste Murphy (Calgary)	403 509 6680	celeste.k.murphy@ca.pwc.com
Vicki Kovacs	416 941 8363	vicki.kovacs@ca.pwc.com
Robert Marsh (Vancouver)	604 806 7765	robert.marsh@ca.pwc.com
Rosemary McGuire	416 869 2599	rosemary.mcguire@ca.pwc.com
Bob Muter	416 941 8243	robert.j.muter@ca.pwc.com
Charles Park	416 814 5883	charles.park@ca.pwc.com
Jim Saloman	416 941 8249	james.s.saloman@ca.pwc.com
Sherrie Shaw	416 365 8809	sherrie.m.shaw@ca.pwc.com
Mike Tambosso	416 941 8388	michael.a.tambosso@ca.pwc.com
Gary Van Haren	416 814 5717	gary.van.haren@ca.pwc.com
Andrew White	416 869 2428	andrew.white@ca.pwc.com
Chris Wood	416 365 8227	christopher.r.wood@ca.pwc.com

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